

# Business Tides

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# Business Tides

The *Newsweek* Era of Henry Hazlitt

Compiled by Marc Doolittle

Introduction by Paul Charles Milazzo

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## A Note from the Compiler

This book would have never gotten off the ground without Jeffrey Tucker's bibliographical work on Henry Hazlitt. That work can be found in both book form (*Henry Hazlitt: A Giant of Liberty*) and on the Mises.org website. The genesis for this book started with that bibliography. I was browsing Hazlitt's prodigious output throughout the years and tried to click on a few of his *Newsweek* editorials. The titles were beguiling: "Global Spending Forever?"; "Our Irresponsible Budget"; "Will Dollars Save the World?" Most of the titles I found myself gravitating toward would make perfect headlines in any newspaper, magazine, or blog today. For some reason the hyper-links were broken, obviously an oversight. But I just had to read them. I immediately went to *Newsweek's* website and searched for back issues. Incredible—nothing online. It occurred to me just how spoiled I had become by Mises.org, where so much information is freely available at the click of a mouse. So after speaking with Jeffrey and concluding that these editorials were truly not available anywhere in print or online, I decided to track them down and in my own small way try to give something back to Mises.org and Henry Hazlitt.

The rest was a simple study in the division of labor: A young student I hired photocopied and scanned old editions of *Newsweek* on the weekends. I spent months trying to digitize the texts using character recognition software. When that failed miserably, I employed a

team of entrepreneurial women and men in New Delhi to transcribe the editorials by hand. India, of all places! I hope Henry Hazlitt would find that as encouraging a sign of freedom as I do.

I would like to acknowledge all of the people who, in addition to the prolific pen of Henry Hazlitt, helped make this book possible. First of all to Lew Rockwell, the Mises Institute, and all of the amazing writers and educators there who have truly changed my life with knowledge. I would like to also thank in particular the following people: Jeffrey Tucker, Paul Milazzo, Trevor Hytmiah, Judy Thommesen, N. Joe Potts, John Russell and the University of Nevada/Reno Students of Liberty, Chad Parish for the cover, and Bhawna Seth, and all the great workers at IdesIndia.com. Most of all, thanks to my wife Sarah, daughters Ruby and Violet and son Walter. They give my life and work meaning.

So please, enjoy the marvelous introduction to these editorials by Paul Milazzo. Paul undertook the herculean task of putting these editorials in thematic and historical perspective and the introduction he has written stands by itself as a major addition to Hazlitt scholarship. Above all, enjoy these beautifully crafted pieces of literature by one of the premier economists and journalists of the twentieth century. Read from the hand of someone with the courage to speak truth to power throughout his entire professional career.

Marc Doolittle, MD  
Chapel Hill, NC  
2011



# Introduction

PAUL CHARLES MILAZZO

Loyal readers of *Newsweek* had reason for disquiet when the latest issue hit the stands on May 3, 1954. Those who managed to endure the details of the ongoing Army-McCarthy hearings or the deteriorating French position in Indochina sought solace, and more stimulating fare, by flipping through as usual to the business section. There, in a series of pieces over the past month, columnist Henry Hazlitt had offered his typically engaging analysis of contemporary economics, examining, in the context of the recent recession, how a more steeply progressive tax code might dampen both government revenues and business profits. Now, however, his “Business Tides” column—a staple of *Newsweek’s* back pages since 1946—was nowhere to be found. Weeks passed, spring gave way to summer, but the troubling void remained. Nervous letters began to flood editors’ in-boxes. “I would like to know what has become of Henry Hazlitt’s column in your magazine,” demanded the executive VP of one Midwestern industrial association, echoing scores of other concerned correspondents. “Frankly, it was the principal if not the only reason that I subscribed.” Such missive-writers shuddered to contemplate whether management had discontinued the column, silencing the most clarion voice for economic liberty in American popular media.<sup>1</sup>

*Newsweek’s* editors elicited a collective sigh of relief upon announcing the return of “Business Tides” on July 12, now that its sixty-year-old author had convalesced from an extended cardiac illness. They also took the opportunity to reintroduce Henry Hazlitt to his audience, describing him as a “genial, quick-moving, soft-spoken Philadelphian” whose forty-year career in journalism began at the *Wall Street Journal* and included distinguished editorial positions at the *New York Evening Mail*, *New York Herald*, *New York Sun*, *Nation*, *American Mercury*, and *New York Times*. An esteemed literary critic and financial reporter, Hazlitt had cemented his national reputation with a best-selling primer on free market economics, *Economics in One Lesson*, published the same year he started at *Newsweek*—where, eight years later, his columns remained “extremely popular with readers.” Hazlitt would remain a fixture at the magazine until 1966, his longevity as a regular

columnist surpassed at his retirement only by Raymond Moley’s.<sup>2</sup>

This extensive volume makes it possible and convenient for another generation to encounter “Business Tides” anew. The pages that follow reproduce every column Henry Hazlitt wrote for *Newsweek* throughout his twenty-year career. They offer both a testament to his diligence and insight, as well as a vantage to rediscover how free-market economic thought in the post-World War II era was transmitted and popularized, and why it endured. Even as recent histories of the American Right have transformed our perceptions of the United States after 1945, the significance of economics has only begun to attract the attention it deserves. The latest accounts emphasize that conservatives occupied a modern vanguard, not an atavistic fringe, in post-World War II politics. During an era of putative liberal “consensus,” their ideas appealed to great numbers of Americans, particularly among the middle class in rapidly developing regions like the Sunbelt. Historians have also come to view World War II less as a bright dividing line, and American conservative thought more as an evolving continuum stretching back to the 1930s. In the process, the focus has shifted from social and cultural issues, particularly with respect to race, to the more overtly economic concerns that generated resistance to the New Deal Order. Recent work has recognized that opposition to liberal economic policies arose not simply out of corporate self-interest or business intransigence, but also from principled libertarian objections voiced by theorists with a coherent critique of state power and an articulate defense of the free market.<sup>3</sup>

<sup>2</sup>“For Your Information,” *Newsweek* (12 July 1954), p. 1; Henry Hazlitt, *Economics in One Lesson* (New York: Three Rivers Press, 1988).

<sup>3</sup>George Nash, *The Conservative Intellectual Movement in America* (Wilmington, Del.: ISI, 1998), Lisa McGerr, *Suburban Warriors: The Origins of the New American Right* (Princeton, N.J.: Princeton University Press, 2001); Donald Critchlow, *Phyllis Schlafly and Grassroots Conservatism* (Princeton, N.J.: Princeton University Press, 2005); Gregory T. Eow, “Fighting a New Deal: Intellectual Origins of the Reagan Revolution, 1932–1952,” Ph.D. Dissertation, Rice University, 2007; Kim Phillips Fein, *Invisible Hands: The Making of the Conservative Movement from the New Deal to Reagan* (New York: W.W. Norton, 2009); Juliet Williams, “The Road Less Traveled: Reconsidering the Political Writings of Friedrich von Hayek,” in Nelson Lichtenstein,

<sup>1</sup>C.W. Anderson to John Denson, 10 May 1954, Folder “Correspondence re: 1954 Heart Attack,” Henry Hazlitt Papers, Foundation for Economic Education Archives.

Recovering Henry Hazlitt's long career serves to advance this unfolding narrative. Hazlitt matters, because over the course of the twentieth century he became the most important economics and business journalist in the country, the most influential mainstream purveyor and popularizer of the Austrian School of free market economics, and, prior to the ascendance of monetarists and supply-siders, the most prominent, articulate, and persistent critic of prevailing Keynesian doctrine. From the Great Depression to the dawn of the Reagan era, Hazlitt applied the tenets of Austrian and classical economists to interpret contemporary economic issues for a mass audience, making a principled case for capitalism and a practical case against the unforeseen negative consequences of statist economic policies. To the extent that many readers sampled the work of Friedrich A. Hayek and Ludwig von Mises directly, they did so on Hazlitt's recommendation. A student, confidante, and patron of these Austrian luminaries, a founding member of the Foundation for Economic Education and the Mont Pèlerin Society, an urbane yet lucid writer with an international reputation, Hazlitt stood at the epicenter of American economic conservatism.

Yet the notoriety Hazlitt deserves has thus far eluded him. Out-sized personalities on the Right tend to draw more popular and scholarly attention, not least because of the media amplifying their messages. The gadfly fusionist William F. Buckley helped consolidate the modern conservative movement by launching *National Review* in 1955, but he also reached the masses through his long-running television program, *Firing Line*, along with popular novels, books, and syndicated columns. Ayn Rand's evocative, idiosyncratic, and philosophical fiction never loosed its grip on the best-seller list or the consciousness of millions of readers. Even Milton Friedman, scion of the Chicago School, managed to parlay his academic genius into a media empire of sorts.

Although a less flamboyant personality like Hazlitt could never hope to close this charisma gap, none should disparage the audience he reached as a journalist in the employ of a mass circulation weekly magazine. His career at *Newsweek* coincided with the rise of the "information press" pioneered by Henry Luce in the twenties and thirties. Luce's entrepreneurial vision led him to perceive a market for a new kind of weekly periodical, one that amassed, condensed, categorized,

and narrated general interest news features in a slicker, more easily digestible form than that offered by stalwart publications like *Century*, *Outlook*, or *Literary Digest*. Launched in 1923, *Time* became the gold standard for newsweeklies by the depression years, staffed by an army of researchers, writers, and editors whose anonymous work bore the trademark stylistic and ideological stamp of their founder.<sup>4</sup>

Luce's overt biases and lucrative readership inspired competitors. Chief among them was *News-Week*, founded in 1933 by Luce's former foreign-news editor, Thomas J.C. Martyn, who described *Time* as "too inaccurate, too superficial, too flippant and imitative" and promised to deliver a magazine "written in simple, unaffected English [in] a more significant format [with] a fundamentally sober attitude on all matters involving taste and ethics." The start-up hemorrhaged money until 1937 when it merged with *Today*, a publication associated with one-time Roosevelt brain-truster and New Deal apostate Raymond Moley. Malcolm Muir, former president of McGraw-Hill, took over as editor-in-chief, while the deep pockets of real estate magnate Vincent Astor kept the enterprise solvent. *Newsweek* soon lost the hyphen but never gained the edge over *Time*, settling in as the nation's second-ranked news-weekly. Critics found its nondescript style of prose and reportage bland, its departmentalization of news derivative of Luce's model. Unlike *Time*, however, it did feature signed columns, and the prospect of escaping relative anonymity helped draw Henry Hazlitt into the fold—that, and the responsibility of penning just one column per week instead of five or more for the *New York Times*, where his position as chief economic editorialist kept him tethered to his desk and left little time for book projects, travel, or family life.<sup>5</sup>

*Newsweek* also delivered an expansive and expanding audience for Hazlitt's writings. During the 1950s, the magazine's circulation increased by 80 percent, reaching 1.5 million by 1961. Its "pass-along" readership,

<sup>4</sup>John Tebbel and Mary Ellen Zuckerman, *The Magazine in America, 1741–1990* (New York: Oxford University Press, 1991), pp. 158–74; James Landers, "Newsweek," in Stephen L. Vaughn, ed., *Encyclopedia of American Journalism* (New York: Routledge, 2008), pp. 362–63.

<sup>5</sup>Tebbel and Mary Zuckerman, *The Magazine in America, 1741–1990*, pp. 306–07; Henry Hazlitt, "My Life and Conclusions," p. 56, Folder "Autobiography Drafts," Box B01, Subject Files, Henry Hazlitt Papers; David E. Sumner, "A History of *Time*, *Newsweek*, and *U.S. News & World Report*," *Encyclopedia of International Media and Communications* (New York: Academic Press, 2003), accessed at <http://www.bsu.edu/web/dsumner/Professional/newsmagazinehistory.htm>.



or those who viewed the periodical's contents without paying directly for it, approached ten times that figure. Millions more encountered Hazlitt's work when *Reader's Digest* reprinted his columns or newspaper editorials nationwide and quoted them. In short, a post-war generation of readers who enjoyed more affluence, education, and leisure time than ever before provided an eager market for the kind of periodicals in which Hazlitt appeared—and an often receptive ear for his free-market analysis. Businessmen and entrepreneurs most appreciated his defense of unencumbered capitalism. General Electric Vice President Lemuel Boulware, for example, made Hazlitt required reading for the company's corporate supervisors, managers, and executives.<sup>6</sup>

More broadly, however, Hazlitt appealed to the growing "suburban warrior" demographic that historian Lisa McGerr identified in her history of the New Right in Southern California. These middle-class Americans, drawn from the Midwest to the Sunbelt's high-tech, white-collar economy after World War II, took up residence in booming industrial metropolitan areas, embraced presidential candidate Barry Goldwater in 1964, drove the subsequent rightward shift of the Republican party, and prepared the way for Ronald Reagan. Neither status-anxious nor backward-looking (as liberal intellectuals at the time assumed), these thoroughly modern men and women imbued the self-identified, grass-roots Right with a political and cultural resilience grounded in "deep-seated conservative ideological traditions." A flood of printed materials generated by conservative writers, publishers and periodicals, passed from household to household and discussed among neighbors, co-religionists, and business associates, helped uphold those traditions. As his fan mail attests, Hazlitt's journalistic contributions circulated prominently within these and other intellectual communities throughout the country.

James L. Wick certainly believed so, and he exhorted Hazlitt not to take lightly the extent of his reach. A Republican activist and later executive publisher of *Human Events*, Wick wrote to Hazlitt in the wake of his work-induced heart attack. Over the course of the last four years, Hazlitt had dutifully filed his column while traveling extensively on the lecture circuit, co-editing the fractious libertarian journal, *The Freeman*, publishing a novel, *The Great Idea*, and appearing as a rotating co-anchor for the Longines *Chronoscope*,

a network news interview program on late-night television (in this sense, Hazlitt, like his more famous friends, was no stranger to multi-media exposure). Wick was "thrilled beyond description" to see "Business Tides" up and running again. "You are among the few people in America on our side who have an enormous following," he insisted. "Your column is read throughout the world. It has an influence beyond any reaction that you get. Some young person of 22 who later may become very powerful may have his views changed or even reversed by continued reading of your column. . . . For every person who writes you there are, as every editor knows, a thousand or ten thousand who feel the same way but don't think to drop you a line."<sup>7</sup>

Wick's letter also serves as a reminder that, despite Hazlitt's loyal following and mass audience, "Business Tides" retained a distinctly counter-cultural flavor. For contemporary readers, these columns offer a glimpse at the wider economic history of the post-1945 era. During that time, Hazlitt assumed the bearing of a dissenter: from price controls and other microeconomic planning mechanisms; from the Marshall Plan and similar foreign aid programs thereafter; from the reigning Keynesian macroeconomic policies that supported full employment and downplayed the risk of inflation; from the expanding welfare state. These positions did not endear him to power brokers in academic circles or the halls of Washington. Moreover, during an era that assigned great cultural capital to credentialed experts in the realm of public policy, Hazlitt's detractors found ample reason to marginalize a libertarian without a college degree.

But through the force of his autodidactic erudition and penetrating prose, Hazlitt established his position in the upper echelon of opinion makers. On a weekly basis, he stood athwart conventional wisdom yelling "stop" while maintaining the first principles of Smith, Mill, Bastiat, Wicksteed, Hayek, and Mises (among others) in public discourse. He did so in the guise of a didactic polemicist, edifying and exhorting an audience of business people, decision makers, and informed laymen, stimulating discussion and debate along the way.

### ECONOMICS IN A THOUSAND LESSONS

Intrepid readers of this volume face a potentially daunting task, since Hazlitt produced 971 columns in his two decades with *Newsweek*. By comparison, Milton Friedman, one of his successors at the magazine, penned around 300 between 1966 and 1984. How best,

<sup>6</sup>"Osborn Elliot, Father of *Newsweek's* Rebirth, Dies at 83," *New York Times* (29 September 2008); Osborn Elliot, *The World of Oz* (New York: The Viking Press, 1980), p. 67; Fein, *Invisible Hands*, pp. 101, 114.

<sup>7</sup>James L. Wick to Hazlitt, 8 October 1954, Folder "Correspondence re: 1954 heart attack," Henry Hazlitt Papers, Foundation for Economic Education Archives.

then, to plumb the depths of such an opus? It helps to keep in mind that this survey begins near the end—Hazlitt's libertarian outlook had essentially matured by 1945, forged during the preceding thirty years of boom, bust, and war. His jeremiad over the course of four post-war presidential administrations, then, retains a certain consistency familiar to those acquainted with his most popular publication.<sup>8</sup>

Hazlitt's stock and trade consisted of exposing persistent economic fallacies cultivated through ignorance of basic economic interrelationships. The eponymous "lesson" offered in *Economics in One Lesson* was to recognize the long-term, secondary consequences of economic policies beyond the immediate benefits sought by pleading interests. For Hazlitt, who channeled the classical economists of the nineteenth century, good economics comprehended both sides of the equation: supply is demand; all credit is debt; exports pay for imports; saving is spending of another sort; one person's income is another's cost. Bad economics did not, and was thus invoked to justify various ill-founded schemes to fix prices, protect domestic markets from foreign competition, and divert tax dollars to subsidize favored industries, commodities, public works, exports, or welfare projects.

In applying the insights of *Economics in One Lesson* writ large to the pressing issues of the day, "Business Tides" also broadcast the basic Austrian tenets animating that book. Hazlitt condemned state intervention in the market, championed free trade, questioned underconsumption as a catalyst for recession, celebrated entrepreneurial creativity, and viewed inflation, rather than unemployment, as first among economic evils. He also emphasized how the spontaneous order of the price system conveyed vast quantities of information among countless market actors, allocating scarce capital, labor, and resources far more efficiently than top-down planning mechanisms ever could.

In this context, the first columns worth sampling are two that preview, by way of parody, nearly all the major themes Hazlitt would treat over the years. In the first, "A Modern Corporation Reports" (9/1/47), a befuddled company president, I.M.N. Addlepate, breezily informs stockholders of his efforts to align corporate practice with the "precepts of the most forward-looking economists and statesmen." Accordingly, the firm boosted wages by 15 percent a month every month to increase national purchasing power—but violated

federal labor laws by doing so without engaging in collective bargaining, making "high-salaried union leaders" appear superfluous. To insure "full employment," the company found ways to reduce efficiency and remove labor-saving machinery, improving job figures by "37.2 per cent last year with no increase in output whatever." To enhance export sales, it granted credits to foreign customers with few concerns about reimbursement; after all, defaulted loans would benefit the nation as a whole by preventing imports and protecting "our home industries." Likewise, issuing bonds in great excess of the corporation's assets was no cause for concern, "because as one big family we merely owe this debt to ourselves." And in the fight against inflation, the company heeded the government's request to reduce prices to a "fair" level far below production costs, triggering an anticipated increase in the volume of sales that reached its apex when the goods were given away for free. Addlepate paints these policies as a triumph of the New Economics, noting just one hiccup: the company had gone bankrupt in the process of implementing them.

In "The Fairdeal Family at Home" (5/29/50), George Fairdeal sits with his wife Alice at breakfast, wondering aloud why buying a new house should prevent them from taking a summer European vacation as well. Why not do both, even if it means borrowing from his brother, Bob? After all, the family deserves the best. Alice demurs, suggesting that such spending would preclude saving for retirement or medical expenses and create an unsustainable debt, since Bob will have to be repaid someday. George scoffs, insisting that the "richest nation in the world" ought to provide old age pensions and medical insurance. Alice points out that government health care and pensions are subsidized by other average taxpayers like themselves, so they would be no better off socializing these costs or thinking "that everybody can be supported at the expense of everybody else." When George protests in the name of equality and fairness, Alice reminds him that redistributive schemes dampen the incentive to earn for both subsidizers and subsidized, reducing the total amount of wealth available for redistribution in the first place. George, unmoved by the connection between production and wealth, sees no reason why the government can't provide for all the needs and wants of citizens. "All you're saying, dear," his exasperated wife retorts, "is that every family should be forced through higher taxes to spend its money on the things you think it needs instead of on the things each family itself thinks it needs." A hungry and distracted George proceeds to inquire about the coffee cake they

<sup>8</sup>Milton Friedman, *Bright Promises, Dismal Performance: An Economist's Protest* (New York: Harcourt, Brace, Jovanovich, 1982), p. ix.

had yesterday, learning to his utter dismay that it has all been consumed.<sup>9</sup>

Apart from proceeding chronologically, approaching “Business Tides” on a thematic basis provides a logical blueprint to peruse Hazlitt’s prodigious output. What follows, then, are some brief synopses of the most common, interrelated themes Hazlitt developed in his columns, leavened with enough relevant historical context to suggest why he might have chosen to address a particular issue when or how he did. Although it is impossible to summarize here all of the positions Hazlitt took or all the subjects he explored, these sections feature some of his most representative and noteworthy columns. Readers are encouraged to consult the footnotes, where more comprehensive citations and suggestions appear.

## INFLATION

The specter of inflation haunted “Business Tides.” More than a third of the columns Hazlitt wrote addressed the issue in some way. Hazlitt’s fixation on inflation stemmed from his immersion in the works of Mises and Hayek, but also reflected a change in public outlook dating from the Second World War. After 1939, the focus of economic concern shifted from depressed to runaway prices, and during the war federal agencies like the Office of Price Administration (OPA) fostered expectations that government controls could administer the problem. In a broader context, since 1933 the New Deal had mobilized consumer and labor groups in a way that promoted a more active conception of “economic citizenship,” conditioning them to approach wages and prices as negotiable targets, properly set through an institutionalized process of bargaining. As the economy grew still more political in the post-war years, the matter of managing inflation assumed center stage.<sup>10</sup> To read about inflation in “Business Tides” is to encounter Henry Hazlitt at his most didactic. Faulty understanding and false diagnoses, he feared, inspired only bogus remedies. Given the inflationary challenges inherent in post-war reconversion and then remobilization for the Korean conflict, he covered the topic most intensely during the Truman years, although subsequent administrations all evoked his displeasure on the subject in varying degrees.

The best place to begin is with a five-part series published between 3 September and 1 October 1951, entitled “Inflation for Beginners,” which, when issued separately by *Newsweek* as a pamphlet, drew over 100,000 requests from readers. Hazlitt characterized inflation as “the increase in the volume of money and bank credit in relation to the volume of goods.” The colloquial interpretation of inflation as merely a rise in prices, he insisted, mistook an effect for a cause. More accurately, expanding the number of dollars in circulation allowed consumers to bid up the prices of things they wanted to buy, effectively reducing the purchasing power of individual dollars—as with anything else, increasing the supply of money decreases the value of the marginal unit. Drawing upon Mises’s *Theory of Money and Credit*, Hazlitt also underscored inflation’s psychological component, noting how the present value of the dollar anticipates the future, “just as the value of a bushel of wheat depends not only on the total present supply of wheat but on the expected future supply and on the quality of the wheat.” Producers and creditors who foresaw further depreciation likewise could be expected to adjust the prices of their goods and services upward to compensate.<sup>11</sup>

Since individual employers, wage-earners, or consumers had no power of their own to grow the money supply, Hazlitt observed, governments stood out as the primary culprits responsible for inflation. Alternative explanations for a general inflation that focused on the velocity of money, shortages of goods (demand pull) or wage-price spirals (cost push) let state actors off the hook for a problem they themselves brought into being. Only governments could create new money, and they could resort to more subtle methods than the printing press to do so. To help finance the war, for example, the Federal Reserve agreed to purchase unlimited government securities from the Treasury at a fixed (or “pegged”) rate of 2.5 percent, creating demand deposits from which the government could draw. Wartime expediency encroached into peacetime, however, and the Fed dutifully continued “monetizing” government debt, flooding the system with dollars, propping up an artificially low interest rate in the bond market, and displacing real savings. Many commentators criticized the practice of “pegging” (which was discontinued in 1951), but few other than Hazlitt lamented how the persistent budget deficits racked up by post-war administrations were regularly subsidized through similar bond sales or

<sup>9</sup>The family name is an obvious take off on “Fair Deal,” the label bestowed on Harry S. Truman’s domestic agenda.

<sup>10</sup>On post-war inflation, see Meg Jacobs, *Pocketbook Politics: Economic Citizenship in Twentieth-Century America* (Princeton, N.J.: Princeton University Press, 2005), pp. 221–61.

<sup>11</sup>For more on inflation, see *Business Tides* (BT) 9/22/47, 12/8/47, 3/1/48/, 10/18/48, 8/1/49, 9/25/50, 5/28/56, and 5/2/60.



note transfers to banks. His special distaste for federal expenditures in excess of tax revenues stemmed foremost from their inflationary effects (although, he hastened to add, while “huge expenditures wholly met out of huge taxes are not necessarily inflationary, they inevitably reduce and disrupt production, and undermine any free enterprise system. The remedy for huge governmental expenditures is therefore not equally huge taxes, but a halt to reckless spending.”) He cautioned as well that the various federal loan and aid programs designed to stimulate everything from the domestic housing market to foreign export trade all formed part of a “concealed budget deficit” exacerbating inflation.<sup>12</sup>

Hazlitt condemned the “swindle” associated with such easy money policies. Between 1939 and 1951, the money supply (circulating currency plus demand deposits) increased 171 percent, which he blamed for the 135 percent rise in wholesale prices during that same period (by 1963, the percentages were 388 and 138, respectively). Estimates of economic growth in this context also proved misleading. In a critique of President Truman’s midyear economic report for 1947, Hazlitt noted that a \$225,000,000,000 gross national product (GNP) sounded less impressive if the relative purchasing power of the dollar amounted to “only 55 cents as compared with the dollar of 1935–39.” Bondholders suffered from similar illusions if they believed the Fed/Treasury collaboration to suppress interest rates acted to preserve the value of their investments (the relationship between bond price and yield is reciprocal). In fact, the long-term inflationary effects of easy money eroded their real value.<sup>13</sup>

For Hazlitt, then, inflation transcended mere economics; he viewed it as a moral issue. Governments reneged on sovereign debts when they knowingly devalued the currency used to pay them off (or, in the case of the United States in 1933, repudiated the obligation to discharge them in gold). But that was just one sin among many. Inflation, Hazlitt emphasized, “depreciates the value of the monetary unit, raises everybody’s cost of living, imposes what is in effect a tax on the poorest at as high a rate as the tax on the richest, wipes out the value of past savings, discourages future savings

... encourages and rewards speculation and gambling at the expense of thrift and work, undermines confidence in the justice of a free enterprise system, and corrupts public and private morals.”<sup>14</sup>

But because inflation, “like Janus,” showed “two opposite faces,” Americans remained confused, ambivalent, and incapable of presenting a “united front” against it. When the wage earner, farmer, or businessman complained about inflation, Hazlitt observed, they usually referenced the prices they paid for the goods and services of others, rather than those garnered for their own. Forgetting that high money incomes and high money prices represent two sides of the same coin, citizens succumbed to the rhetoric of politicians who promised to promote heads while containing tails. Rather than halting the expansion of money and bank credit, for example, President Truman endorsed higher industrial wages and agricultural commodity prices to keep up with the cost of living, while calling on businesses to reduce their prices voluntarily and lamenting the burden high rents exerted on city dwellers. Yet, Hazlitt observed, since 1939 industrial wages had risen far ahead of rents, just as the price of agricultural commodities had outstripped that of other goods. “The real evil of inflation is that it redistributes wealth and income in a wanton fashion often unrelated to the contribution of different groups and individuals to production,” he noted. “All those who gain through inflation on net balance necessarily do so at the expense of others who lose through it on net balance. It is an illusion to suppose that the losers can ever be brought abreast of the gainers except by setting the gainers back. And it is often the biggest gainers by inflation who cry the loudest that they are its chief victims.” Policy makers’ hypocrisy when dealing with the causes of inflation, Hazlitt warned, invariably bred counterproductive statist solutions like price controls. Political rhetoric that treated higher wages and farm income as “virtuous and welcome, but higher profits as a disaster and a sin” prepared the way, since it obscured the function of profits both as an incentive to production as well as a source of capital expansion and employment.<sup>15</sup>

For Hazlitt, the cure for inflation was to stop inflating. For two decades, his advice to policy makers remained consistent: stop running deficits and monetizing government debt, cut the budget, maintain higher legal reserve ratios for Federal Reserve banks, don’t hold interest rates at artificially low levels, eliminate foreign

<sup>12</sup>On the pegging policy, see *BT* 12/22/47, 8/30/48, 9/27/48, 10/4/48, 10/18/48, 9/4/50, 1/15/51, 2/5/51, 2/19/51, 3/12/51, 5/14/51, and 5/23/53. For the relationship between deficit spending and inflation, see *BT* 8/4/47, 5/9/49, and 7/25/49.

<sup>13</sup>*BT* 8/4/47. See also Hazlitt, *What You Should Know About Inflation*, 2nd ed. (Auburn, Ala.: Ludwig von Mises Institute, 2007), pp. 1–3, 10–11, 76–78, 130–32. This volume also contains materials originally published in “Business Tides.”

<sup>14</sup>*BT* 10/1/51 (quote).

<sup>15</sup>*BT* 12/29/47, 6/16/47, 3/29/48, 8/14/50, 9/25/50, 2/12/51, 5/14/51, and 8/6/51.



aid and similar loan programs, and commit to returning to the gold standard. As he informed his readers, however, government officials had few incentives to follow this advice, because they had a vested interest in promoting policies that sustained a perpetual inflation. He characterized this inflationary orientation, in turn, as a direct consequence of the regnant economic doctrine of the post-war period: Keynesianism.

### KEYNESIAN ECONOMICS

Hazlitt wielded a broad brush when depicting the landscape of Keynesian economics. He never drew distinctions between, say, John Maynard Keynes himself or his American disciples; between Keynesian theory and Roosevelt's often ambivalent New Deal feints in that direction; between Depression-era proponents like Alvin Hansen, who believed a "mature" American economy required the government to serve indefinitely as an employer of last resort, or post-1945 liberals like Leon Keyserling, whose renewed faith in that economy following World War II led them to favor growth, rather than redistribution, as the path to prosperity and income equality; between laborite proponents of public sector spending and high wage policies or more conservative "corporate" Keynesians who favored military contracts and tax cuts.<sup>16</sup>

Whatever the iteration, Hazlitt judged the commanding status of the New Economics as "one of the great intellectual scandals of our age," a doctrine destined to enervate capitalism in the long run rather than rescue it from its putative excesses and enemies. His critiques of Keynesianism usually addressed one or more of the following basic tenets: (1) aggregate demand and consumer purchasing power provided the engine for economic stability and growth; (2) to sustain them, the government had the responsibility for maintaining "full employment," given the inherently unstable nature of the market economy; (3) state actors possessed the knowledge and technical capacity to do so using macroeconomic instruments; (4) countercyclical measures to prevent economic downswings and maintain "full

employment" abided annual budget deficits when necessary; and (5) a little inflation could be traded off for higher employment. Hazlitt often employed the term "compensated economy" as shorthand for these prescriptions, or the belief that "it is the government's function to 'stabilize' the economy and to 'compensate' for the mistakes of private business." He penned dozens of columns detailing why this was neither possible nor desirable; a number of them written in 1958–59 previewed the arguments he would present in *The Failure of the New Economics* (1959), an intensive critique of Keynes's 1936 magnum opus, *The General Theory of Employment, Interest, and Money*.<sup>17</sup>

At root, Hazlitt defined Keynesianism as a prescription for inflation and false prosperity. Keynes desired to remedy a problem that "orthodox" proponents of Say's Law supposedly never acknowledged: chronic unemployment at market equilibrium. Indeed, he considered full employment at equilibrium the exception rather than the rule, and sought a "General Theory" applicable beyond this special case. According to Hazlitt, Keynes never accepted downward wage flexibility as a solution to unemployment, because he believed it politically unworkable. Labor would, however, accept (or otherwise not notice) a decrease in real wages. Thus government efforts to achieve "full employment" by stimulating aggregate demand operated, in effect, to lower the value of money, raising the selling prices of commodities far enough ahead of wages to maintain temporary profit margins. The subsequent appeal of such policies reflected the haunting memory of the Great Depression and the "delusion that under inflation we can gain more in our role as sellers and producers than we must lose in our role as buyers and consumers."<sup>18</sup>

Hazlitt rejected this strategy. He believed Keynes's misreading of Say's Law led him to promote a fallacious, demand-driven model of the economy that obscured the role of production (supply) in creating demand. "Mere inflation" and the higher prices and wages that resulted only appeared to do so, but "in terms of the actual production and exchange of real things" it did not. Rather, inflationary booms distorted "the structure

<sup>16</sup>See Robert Skidelsky's three volume biography, *John Maynard Keynes* (New York: The Penguin Press, 1994); David C. Colander and Harry Landreth, eds., *The Coming of Keynesianism to America* (Cheltenham, U.K.: Edward Elgar, 1996); O.F. Hamouda and B.B. Price, eds., *Keynesianism and the Keynesian Revolution in America* (Cheltenham, U.K.: Edward Elgar, 1998); Donald K. Pickens, *Leon Keyserling: A Progressive Economist* (Lanham, Maryland: Lexington Books, 2009); Alan Brinkley, *The End of Reform: New Deal Liberalism in Recession and War* (New York: Alfred A. Knopf, 1995).

<sup>17</sup>Henry Hazlitt, "On Analyzing Keynes," *National Review* VII (7 November 1959), pp. 453–56. On the "compensated economy, see BT 8/4/47 (quote), 1/31/49, 5/9/49, and 3/14/55.

<sup>18</sup>BT 5/7/51 (quote). On Say's Law, see Henry Hazlitt, *The Failure of the New Economics* (Auburn, Ala.: Ludwig von Mises Institute, 2007), pp. 32–42 and Steven Kates, *Say's Law and the Keynesian Revolution: How Macroeconomic Theory Lost Its Way* (Cheltenham, U.K.: Edward Elgar 1998), pp. 207–08.

of production,” promoted misallocations of capital and resources, invited economic collapse, and reduced long-run productivity and profits, the only authentic sources of economic growth and real income. Likewise, a weakened dollar acted to diminish the purchasing power Keynesians so cherished.<sup>19</sup>

When the 1946 Employment Act declared it a government policy to maintain “maximum production, maximum employment, and maximum purchasing power,” one available method to go about it was deficit spending reminiscent of the World War II experience. While Hazlitt condemned the inflationary effects of “priming the pump” in this way, he also questioned the assumption that “what principally determines the level of economic activity is the volume of government spending.” He underscored the point using the specific case of defense expenditures, where supposedly “the more resources we are forced to devote to making guns and tanks and shells, instead of consumer goods, the richer we become.” But, he argued, assume for the moment that taxes ultimately paid for defense expenditures. If in 1953, as the Korean War wound down, “defense payments suddenly dropped from the present \$50 billion a year to only \$10 billion, taxes could also be cut by \$40 billion. Then the taxpayers. . . would have \$40 billion more to spend than they had before, to make up for the \$40 billion drop in government spending.” While the pattern of production would change, “there is no reason to suppose that the over-all volume of output or activity would decline.” In actuality, however, tax receipts did not cover the full cost of defense expenditures. The prosperity affiliated with Keynesianism, military or otherwise, derived from the inflationary effects of deficit spending, which, Hazlitt emphasized, could not be planned or controlled in the long run.<sup>20</sup>

For Hazlitt, inflationary Keynesian policy was inherently a monetary policy, regardless of its fiscal dimensions. “Debauching the currency is the oldest and most discredited trick in the world,” he noted, “and this is all there is to the much-touted “Keynesian

revolution” when you take its sophisticated clothes off.” The Keynesian embrace of “government planning in the field of money and credit,” however, was not limited to the Left. According to the historian Robert Collins, the brand of deliberate Keynesianism adopted by post-war administrations was that embraced by corporate elites. It nominally eschewed large-scale discretionary government expenditures for the stability and relative “automaticity” of tax cuts and monetary manipulation. A number of more conservative actors, from the businessmen on the influential Committee for Economic Development (CED) to President Eisenhower and the chairman of his Council of Economic Advisors, Arthur Burns, advocated countercyclical policies to address economic downturns and maintain employment levels. They favored monetary instruments (manipulating the discount rate, reserve requirements, and open market operations) as among the least intrusive alternatives.<sup>21</sup>

Indeed, the Eisenhower administration’s resort to such options during the recessions of 1953–54 and 1957–58 (in part to facilitate government deficit borrowing) prompted Hazlitt to declare, in a July 1954 column, “We are all Keynesians now.” Students of history will associate those words with Milton Friedman, who was said to have uttered them in reference to the economic *zeitgeist* circa 1965 and the enthusiastic Keynesianism of the Kennedy-Johnson White House. Yet more than a decade earlier, prior to the ascent of Samuelson, Heller, or Tobin, Hazlitt coined the phrase in response to an administration known more for its concern about balanced budgets. The sentence that followed helps to clarify: “*We are all monetary inflationists.*” While sympathetic to Eisenhower’s efforts, Hazlitt still criticized ballooning federal expenditures, continued deficits, and low discount rates relative to international norms. In particular, he believed Keynesian easy money advocates misunderstood how the structure of interest rates provided incentives for savers. Seeing only the borrower’s side of the equation led to artificial rate reductions that “discourag[e] normal thrift, savings, and investment” and “reduc[e] the accumulation of capital” that actually drove job growth. When the administration did manage a balanced budget (as it did in 1956, 1957, and 1960), he suggested that surpluses alone could not prevent inflation if the supply of money and credit remained bloated.<sup>22</sup>

<sup>19</sup>See Hazlitt, *Economics in One Lesson*, pp. 164–76.

<sup>20</sup>On “military Keynesianism,” see *BT* 4/20/53, 11/9/53, 10/3/55 (quote), and 1/12/53. On the 1946 Employment Act, see Jacobs, *Pocketbook Politics*, p. 233. Hazlitt denied that deficit spending had any “multiplier effect” on employment or economic growth, citing the deficits run during the 1930s and the rate of unemployment during that time. As a percentage of GNP, he argued, the deficits of the 1930s were larger than those of the post-war period, and the deficit-spending of World War II represented too extreme an example to serve as a model to follow. See Hazlitt, *The Failure of the New Economics*, pp. 135–55, 421–26.

<sup>21</sup>*BT* 8/1/49 (quote) and 6/28/48 (quote); Robert M. Collins, *The Business Response to Keynes, 1929–1964* (New York: Columbia University Press, 1981).

<sup>22</sup>Quote: *BT* 7/5/54; see also “The Economy: We Are All Keynesians Now,” *Time* (31 December 1965). On the

Even in the midst of recession, then, inflation concerned Hazlitt more than unemployment. He trusted the workings of a free market would alleviate the latter, while the encroachments of the state created and exacerbated the former. Accordingly, Hazlitt placed little faith in countercyclical strategies to “smooth out” business cycles. “It is no accident that the most violent fluctuations in prices, production, and employment have corresponded with the period of most government interference in business,” he observed with a nod toward Austrian theories of the business cycle. “Most major modern business oscillations have been the result either of credit and currency expansion deliberately instigated by government, followed by inevitable collapse, or at least by failure of government to halt an unsound credit expansion until too late. The best government ‘countercyclical’ policy would be to keep an inflationary boom from starting, not to try to whip it up again after it has begun to flag.”<sup>23</sup>

As Keynesians became more overt in their stated desire to sustain particular levels of economic growth in the late fifties and sixties, Hazlitt focused his attack on the aggregate statistical concepts they employed. He did not harbor the same animus toward mathematical modeling in economics as Ludwig von Mises did, finding, for example, the empirical data compiled by Simon Kuznets useful enough to cite on more than one occasion. Compared to members of the Chicago School, however, whose highly technical work retained a macroeconomic focus, Hazlitt was wont to find such measures as gross national product and national income arbitrary and unreliable. Not only did he consider GNP calculations of economic growth exaggerated by inflation, he also thought it fanciful that executive branch experts could predict national income

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administration’s Keynesian outlook, see *BT* 7/19/54 and 9/19/55. For a critique of Arthur Burns (whom Hazlitt generally admired), see *BT* 11/8/54. Generally speaking, Eisenhower prioritized deficit reduction and currency reduction (especially after 1959). See John Sloan, *Eisenhower and the Management of Prosperity* (Lawrence: University Press of Kansas, 1991), pp. 69–151. Hazlitt saw the problem of interest rates as an outgrowth of flawed Keynesian concepts like the “propensity to consume,” “liquidity preference,” and an inconsistent definition of the relationship between savings and investment, all of which led Keynes to a problematic understanding of interest rates and how they operated. The upshot was a Keynesian disparagement of savings. See Hazlitt, *Economics in One Lesson*, pp. 177–90 and *The Failure of the New Economics*, pp. 49–54, 78–131, 186–212. On interest rate-fixing as a kind of price-fixing, see *BT* 12/20/65.

<sup>23</sup>*BT* 6/29/53 (quote), 7/13/53.

when they had a hard enough time predicting the size of the annual budget deficit. In the late fifties, Hazlitt refuted Walter Lippmann and other pundits who cited the Soviet Union’s explosive economic expansion as a spur to accelerate U.S. growth rates. Hazlitt’s Austrian-influenced analysis of socialist systems produced a healthy skepticism about the veracity of Soviet statistics or likelihood that a command economy without a price system could meaningfully increase outputs of agricultural or consumer commodities.<sup>24</sup>

Suffice it to say, Hazlitt did not share the Keynesians’ confidence in cyclical or “full-employment” budgets that tolerated deficits in years of economic decline and anticipated surpluses in growth years. Balancing income and expenditures over the course of an economic cycle, rather than a single fiscal year, presented two dilemmas. The first involved a straightforward knowledge gap. “No one knows when an ‘economic cycle’ has begun or ended,” he noted, “or just where we are in it, or when employment is ever high enough to take the terrible risk of balancing or overbalancing the budget.” The second, however, invoked the broader politics of the budgeting process and the very nature of the welfare state—reinforcing on another front Hazlitt’s misgivings about the viability of the entire Keynesian project.<sup>25</sup>

#### THE FEDERAL BUDGET AND THE WELFARE STATE

Roughly every January, “Business Tides” conducted the same grim ritual: reviewing the annual federal budget. Pick any of these columns at random, and a palpable sense of *déjà vu* overtakes the reader. Each year, Hazlitt

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<sup>24</sup>On GNP and national income, see *BT* 4/21/58, 8/25/58, 1/5/59, 1/12/59, 9/26/60, 3/18/63, 6/8/64, 7/19/65, 9/27/65 and *The Failure of the New Economics*, pp. 409–20. Although Hazlitt spoke of a shift in Keynesian emphasis from “full employment” to “growth,” Robert Collins argues that the latter impulse was there from the beginning, particularly as advocated by Leon Keyserling. See *More: The Politics of Economic Growth in America* (New York: Oxford, 2000), pp. 40–67. On the differences between the Austrian and Chicago School, see Mark Skousen, *Vienna & Chicago, Friends or Foes?: A Tale of Two Schools of Free Market Economics* (Washington, D.C.: Capital Press/Regnery, 2005). On the Soviet economy, see *BT* 8/25/58, 2/16/59, 3/2/59, 3/9/59, and 7/20/59. On command economies and the price system, see Ludwig von Mises, *Socialism: An Economic and Sociological Analysis* (Indianapolis, Ind.: Liberty Classics, 1981).

<sup>25</sup>*BT* 8/4/47, 1/31/49, 12/19/49, 2/20/61, 4/17/61, 5/8/61, 2/5/62, 7/20/64, and 1/17/66. On the full employment budget in particular and balanced budgets in general, see James D. Savage, *Balanced Budgets and American Politics* (Ithaca, N.Y.: Cornell University Press, 1988), pp. 175–79.



lamented a budget larger than the last, “a constantly mounting percentage even of our inflated national income.” In 1949, Truman’s \$42 billion offering equaled “the amount spent in the entire five peacetime years from 1935 to 1939 inclusive. And few people ventured to describe those Roosevelt spending years as models of economy at the time.” The \$73.9 billion budget for fiscal 1959 included a then-record \$28.1 billion for non-defense spending, not counting trust funds for social security and highways (another \$16 billion). The stated estimate of \$97.9 billion for fiscal 1965 actually came in at a half-billion less than that for 1964, although Hazlitt believed the Great Society’s aspirations would render such optimism laughable—he had seen it happen too many times before. So too, the attitude toward economizers he first noted during the Truman era proved applicable for every administration thereafter:

Apologists for this budget are already falling back on the familiar technique of trying to silence its critics by asking rhetorically: “Where would you cut?”.... The burden of proof, on the contrary, must be placed for each item squarely on the shoulders of those who demand the expenditures. And it is not enough for them to prove, even if they could do so, that everything that these expenditures will buy is “needed.” They must prove that the citizens of the country need each of these things even more than they need the things for which they would spend their own money if it were not taken away from them in taxes.<sup>26</sup>

Hazlitt’s annual budget litany served to undercut the view of full-employment budgets as automatic instruments fine-tuned by experts and immune somehow to the distributive impulses ingrained in democratic, interest-group politics. In 1966, he noted that only 6 out of the last 36 budgets had run surpluses; yet the United States had not exactly suffered thirty years of recession justifying those deficits. In reality, Hazlitt observed, few politicians had the wherewithal to sustain the deflationary or budget-cutting measures required in years of surplus, for few wanted to face the wrath of client interests who benefited from inflationary policies. Rather than encourage automatic budgetary adjustments, Keynesian policies seemed to validate the worst

instincts of solicitous politician’s intent on extending economic booms indefinitely through unchecked social spending.<sup>27</sup>

Hazlitt anticipated the economists of the Public Choice School in the 1970s, then, in arguing that Keynesian policy facilitated and accelerated rent seeking. Although he never evoked that specific terminology, “Business Tides” offered a mountain of evidence to support the assertion. For two decades, Hazlitt chronicled ever-ballooning post-war federal expenditures in the form of agricultural subsidies, subsidized low-interest mortgages, educational and small business loans, welfare spending, foreign aid, water projects, and highways. Such deficit-inducing programs offered countless examples of the “one lesson” unlearned. Since funding for the welfare state did not come from “the fourth dimension,” it had to come from either inflationary borrowing or taxation. Taxes effectively transferred the income of the politically unconnected to the politically connected, offering no net social benefits but merely increasing the purchasing power of certain interests at the expense of others. Burgeoning government programs did not “meet more national needs,” as President Kennedy claimed in 1963. Rather, they caused “every tax-paying family to meet fewer of its own needs, [leaving] less for private persons and private business to invest in the future, in increased productivity or economic growth.” Like inflation, the welfare state offered merely the illusion of prosperity.<sup>28</sup>

Hazlitt underscored the role of interest groups and bureaucratic self-promotion in the perpetuation and expansion of the administrative state. Observing the British system led him to speculate, astutely, whether

<sup>27</sup>BT 8/4/47, 1/31/49, 12/19/49, 2/10/61, 4/17/61, 5/8/61, 2/5/62, and 1/17/66. By 1966, Hazlitt recognized the “embarrassing dilemma” President Johnson faced after forging ahead simultaneously with the Great Society and the escalating war in Vietnam: “With the economy already overheating, with labor shortages in many lines, with consumers’ prices every month going to a new high record, how big a deficit can be tolerated in the next fiscal year, without letting loose a serious inflation?”

<sup>28</sup>John L. Kelley, *Bringing the Market Back In: The Political Revitalization of Market Liberalism* (New York: New York University Press, 1997), pp. 44–51; Hazlitt, *Economics in One Lesson*, pp. 31–36, 90–97, 98–102, 110–16; On housing, see BT 11/7/49, 7/24/50, 7/31/50, 8/10/53, 8/22/55, and 1/2/56; on the welfare state generally, see BT 8/9/48, 5/29/50, 11/19/51, 2/18/57, 5/23/60, 6/13/60, 7/18/60, 7/18/60, 8/1/60, 8/8/60, 2/29/60, 1/22/62, 8/6/62, 2/4/63 (quote), 6/24/63, 4/6/64, 7/6/64, 8/24/64, 9/14/64, 1/18/65, 4/26/65, 11/22/65, and 2/28/66.

<sup>26</sup>BT 1/24/49 (quote), 1/27/58, and 2/10/64.

“the welfare state, once embarked upon, set up such powerful vested interests for its own preservation that it . . . becomes irreversible.” Closer to home, the farm program stood out as a particularly egregious example of an “emergency” initiative (designed to raise severely depressed farm prices during the 1930s) that achieved profligate permanency thanks to the workings of bipartisan “iron triangle” politics. Dedicated farm groups, congressional subcommittees, and the Department of Agriculture succeeded in erecting a program of price supports that served to “raise the cost of food to our own poor, to pile up huge unsold farm surpluses in government warehouses, and to stimulate food giveaways or cut-rate sales to foreign (including Communist) countries.” It did so for the stated purpose of closing the income gap between farm and non-farm labor, even as the price of agricultural commodities rose higher than average during the post-war period. This gift from taxpayers to farmers, which subsidized a massive unsold surplus, prompted Hazlitt to wonder, in the spirit of *reductio ad absurdum*, why the parity principle wasn’t just applied universally: “why not . . . demand equality of everybody’s income with everybody else’s, regardless of his contribution to production” and sever any lingering connection between “income received and value produced?”<sup>29</sup>

“Neoconservatives” of the 60s and 70s are usually credited with bringing social science research methodologies to bear on Great Society social programs and introducing the concept of “unintended consequences” to policy debates. Yet Hazlitt routinely applied economic analysis to a host of government programs to reveal their unforeseen shortcomings, inequities, and market inefficiencies.<sup>30</sup> In 1962, he wrote with concern about the “unfunded liabilities” of the social security system and noted that the Medicare program introduced under Kennedy stood to “give heavy (unearned) benefits to the present aged and load the cost onto the present young.” During the fifties, he detailed how transforming unemployment insurance into a more generous relief program “dampen[ed] incentives to

find work quickly,” penalized those who worked part time, “subsidiz[ed] the unemployment created by excessive wage rates, and reliev[ed] the pressure on powerful unions to bring wage rates down to the level at which full employment could be restored.” Likewise, raising minimum wage laws, a popular initiative with every administration, increased unemployment among low-paid workers, precisely those most targeted for assistance. “The first thing that happens when a law is passed that no one shall be paid less than \$1.25 an hour is that no one whose work is not deemed worth \$1.25 an hour will be employed at all,” he noted, depriving such laborers “of the right to earn the amount that [their abilities] permit [them] to earn.”<sup>31</sup>

Hazlitt did not dedicate as much space to Lyndon Johnson’s “War on Poverty” in “Business Tides” as he would in later books like *Man vs. the Welfare State* and *The Conquest of Poverty*, but offered some perceptive critiques all the same. “The problem of curing poverty is difficult and two-sided,” he noted. “It is to mitigate the penalties of misfortune and failure without undermining the incentives to effort and success.” Johnson’s flood of social legislation, on the other hand, more resembled a set of government interventions intended to “try to cure evils brought about by previous government interventions.” Duplication was inevitable. The Job Corps and similar manpower training programs, for example, cost \$340 million and overlapped with existing Kennedy-era initiatives. But these expensive efforts stood to assist only a relatively small number of enrollees, few if any of whom represented the poorest, least skilled workers (later critics would similarly underscore this tendency for poverty programs to benefit the better off disproportionately). Hazlitt was also prescient enough to see that Johnson’s aspirations for “total victory” over poverty far outstripped programmatic expenditures of under \$1 billion per year. “This comparatively tiny price tag for such a vaultingly ambitious goal, one suspects, is merely a way of getting the camel’s head in the tent,” he observed. “If the history of social security is any guide, we can expect the price tag to increase geometrically as the years go on.”<sup>32</sup>

<sup>29</sup>BT 10/12/64 (quote), 4/25/49 (quote), 9/22/52, and 4/26/65 (quote). On agricultural subsidies generally, see BT 4/25/49, 5/21/51, 9/22/52, 2/8/54, 2/22/54, 1/10/55, 8/22/55, 10/24/55, 10/31/55, 11/14/55, 12/19/55, 1/30/56, 3/26/56, 4/23/56, 4/30/56, 6/18/56, 2/18/57, 4/8/57, 6/22/59, 11/30/59, 8/15/60, 7/9/62, 7/23/62, 6/10/63, and 10/14/63.

<sup>30</sup>Worlds collided in an amusing way in a June 24, 1963 column, where Hazlitt described neo-conservative cynosure Irving Kristol as one of many liberals “showing signs of disillusion with the welfare state that they once so ardently espoused.”

<sup>31</sup>On Social Security and Medicare, see BT 10/17/49, 2/29/60, 5/23/60, and 8/6/62 (quote); on unemployment insurance, see BT 4/24/50, 3/10/58, and 3/31/58 (quote); on the minimum wage, see 3/20/61 (quote), and note 47 below.

<sup>32</sup>Henry Hazlitt, *Man vs. the Welfare State* (New Rochelle, N.Y.: Arlington House, 1969) and *The Conquest of Poverty* (New Rochelle, N.Y.: Arlington House, 1973); BT 1/27/64 (quote), 4/6/64 (quote), 8/24/64 (quote), 10/12/64, and 1/18/65. On the unintended consequences of Great Society Programs, see Allen J. Matusow, *The Unraveling of America:*

Hazlitt likewise took note when liberal defenders of the welfare state in the Kennedy-Johnson years began to advocate what he called “the socialization of consumption,” a position most commonly associated with Harvard economist John Kenneth Galbraith. Galbraith exerted little direct influence on White House economic policy, dissenting from Kennedy’s Council of Economic Advisors when it endorsed a Keynesian tax cut. But he remained a renowned public intellectual, best known for books like *The Affluent Society*. There and elsewhere, he argued that liberals needed to rethink their emphasis on corporate Keynesianism and target income inequality more directly, increasing government spending on public infrastructure rather than relying on economic growth alone to close the gap.<sup>33</sup>

Galbraith’s thesis prompted spirited dissents from Hayek and other economists associated with the Mont Pèlerin Society, but Hazlitt’s own series of columns on the subject summarized their objections in bracing terms. As Hazlitt saw it, Galbraith had abandoned the old socialist contention that capitalism could never obtain optimum production or improve the standard of living of the working class. The problem now was that capitalist production worked all too well, directing too much wealth into the hands of the middle class, who spent it excessively on the consumer goods the economy generated in overabundance.

In recommending a redirection of resources via taxation from the private to the public sector, Hazlitt observed, Galbraith scored a semantic victory by implying the selfishness and wastefulness of the former and the democratic, public spiritedness of the latter. But Hazlitt preferred to describe the private sector as the “voluntary sector” (where people spend their own money on goods and services as they see fit) and the public sector as the “coercive sector” (where, in the words of Bastiat, “everybody tries to live at the expense of everybody else”). For Hazlitt, Galbraith’s thesis supposed that “people are individually unfit to spend the money they themselves have earned, but somehow able to choose wisely the officeholders who will seize the money and spend it for them.” Moreover, it assumed that “people will continue to work to earn the same

amounts or more, no matter how much their freedom to keep or spend their earnings is curtailed.” Galbraith ultimately erred in decoupling goods and income: without the former, which he found excessive, the latter, which bureaucrats coveted, would not exist. In the end, it was the public sector that proved wasteful, selfish, and parasitic on a private sector that created and sustained the affluence Galbraith derided. The workers of the world, Hazlitt concluded, “have enormously more to gain from continuous increase in per capita production than from any conceivable redistribution.”<sup>34</sup>

### PLANNING AND ECONOMIC CONTROLS

The qualms that liberal intellectuals like Galbraith expressed about consumer decision-making in the private sector paralleled the suspicions bureaucrats held about the price system in general. As Hazlitt often reminded his readers, prices convey information that helps countless individuals solve complex problems of production, distribution, and consumption in a decentralized marketplace. But administrative experts preferred to solve these problems by employing technocratic methods within centralized institutions. Disturbed by a system they did not entirely understand, planners sought constantly to improve or correct it, “usually in the interests of some wailing pressure group.”<sup>35</sup>

In this context, Keynesian policy prescriptions proved so troubling because they did not merely involve “non-invasive” macroeconomic manipulations, as many proponents claimed. For Hazlitt, Keynesian policies led ineluctably to an escalating series of microeconomic controls, statist planning schemes, and restrictions on individual freedom, not to mention long-term economic decline: a road to serfdom and impoverishment. Accordingly, “Business Tides” chronicled how the Truman, Kennedy, Eisenhower, and Johnson administrations habitually turned to microeconomic planning to mitigate the inflationary effects of the macroeconomic policies they pursued.<sup>36</sup>

In a spate of articles condemning Truman’s various flirtations with price control programs, Hazlitt noted “the spectacle of a government’s assuming to protect us from the consequences of its own policies by asking for more powers against “speculators,” producers, and “profiteers.” Of course, “voluntary” business efforts could do nothing to hold down prices if the administration ran deficits and expanded currency and bank credit. But

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*A History of Liberalism in the 1960s* (New York: Harper and Row, 1984), pp. 97–127, 217–71.

<sup>33</sup>Richard Parker, *John Kenneth Galbraith: His Life, His Politics, His Economics* (Chicago: University of Chicago Press, 2006); Kevin Mattson, “John Kenneth Galbraith: Liberalism and the Politics of Cultural Critique,” in *American Capitalism: Social Thought and Political Economy in the Twentieth Century* (Philadelphia: University of Pennsylvania Press, 2006), pp. 88–108.

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<sup>34</sup>BT 7/18/60, 6/27/60 (quote), 11/14/60 (quote), 1/22/62, and 9/24/62.

<sup>35</sup>Hazlitt, *Economics in One Lesson*, pp. 108–09.

<sup>36</sup>On Keynesianism and controls generally, see BT 6/28/48, 7/25/49, 11/27/50, and 5/7/51.



imposing arbitrary ceilings prevented adjustments in relative prices necessary to “[synchronize] the production of thousands of different commodities in relation to each other,” resulting in the very shortages officials decried. When Democrats denounced “profiteers” (but not, he noted, union “wageteers”), they ignored how profits actually guided output to alleviate shortages while providing the capital to increase production and wages. Some businessmen held out the prospect of “fairly administered” price-fixing plans allowing them “cost of production plus a reasonable profit” to achieve these same ends. But, Hazlitt noted, such a scheme wouldn’t work, since “a uniform percentage profit for everyone . . . would give no more incentive for producing an article in critically short supply than one in relative excess.” Thus, production bottlenecks were endemic, as evident during the national meat shortage in 1946 that so angered Americans and eroded popular support for the OPA:

As a result of ceilings, cattle raisers found it more profitable to fatten their cattle on the lots than to send them to market. This led to a whole series of other shortages. A soap crisis is being created because soap is mainly made from tallow and tallow comes from steers. Synthetic rubber and hence tire production are threatened in turn by the shortage of soap. A meat shortage also means a hide, leather, and shoe shortage. A bread shortage may come from a scarcity of lard needed in baking, for lard comes from hogs.<sup>37</sup>

Not even the most brilliant bureaucrats could solve the calculation problems price controls imposed, Hazlitt concluded, channeling Mises. With something like 9 million different prices in the United States, and 40 trillion interrelationships between them, “general” price controls remained a totalitarian fantasy. But instituting more targeted controls, he observed, resembled squeezing a balloon: holding down the price of certain goods in an economy inflated with a greater volume of money will simply lead to distortions elsewhere, as consumers’ dollars flow to bid up the prices of uncontrolled

commodities. An extension of controls on beef, pork, and lamb in September 1946 caused the prices of their substitutes, poultry and eggs, to rise, for example, until they were removed.<sup>38</sup>

Accordingly, Hazlitt bucked conventional wisdom in refusing to attribute a spike in prices to the lifting of wartime controls in November 1946. Cost-of-living indexes that suggested price stability between 1942 and mid-1946 peddled a fiction, he insisted, since the fog of wartime controls masked the true extent of credit inflation and ignored “the realities of black market prices, shortages, rationing, queues, favoritism, deterioration of quality, and non-existent goods.” Even though some prices rose sharply in the wake of decontrol, he cautioned, others would decline, “for the very reason that all commodities will be competing freely for the consumer’s dollar, so that if more of it has to go for one commodity, less of it will be left for others.” He also urged the phasing out of lingering controls, like those for rent, which only “intensified the housing shortage by encouraging existing tenants to use space wastefully, and by discouraging repairs, improvements, and new construction.” Not surprisingly, Hazlitt counseled against imposing similar types of controls during the mobilization effort for Korea in 1950–51.<sup>39</sup>

Even after the formal lifting of wartime price controls, Hazlitt could point in future years to other inefficient forms of control and planning: agricultural price supports, the continuation of rent control, JFK/LBJ “wage-price guideposts,” consumer credit controls, and, with the onset of the balance of payments problem after 1957, various exchange controls and restrictions on foreign investment. The “parity formula” in agriculture, for example, attempted to freeze in place World War I-era price relationships that happened to favor farmers even as it forced city workers to pay more for food. If it were really possible to preserve dynamic price relationships in amber this way, Hazlitt mused, why not do so universally for everything from freight rates to neckties? Why not adjust the parity rate downward if agricultural prices exceeded those of other goods (not surprisingly, no one in the farm bloc ever suggested such a thing). The political favoritism inherent in the administration of the parity principle even victimized other farmers, as it applied to certain select commodities but not others—boosting wheat growers, for example, while sticking

<sup>37</sup>*BT* 12/1/47 (quote), 12/8/47 and 10/21/46 (quote). On price controls generally, see *BT* 9/30/46, /10/7/46, 10/14/46, 10/21/46, 10/28/46, 11/18/46, 7/28/47, 9/15/47, 12/1/47, 2/16/48, 4/5/48, 5/2/48, 8/2/48, 7/10/50, 8/14/50, 9/18/50, 1/8/51, 4/9/51, 4/23/51, 5/14/51, 8/13/51, 12/22/52, 4/6/53, 6/7/53, and 11/11/57.

<sup>38</sup>*BT* 10/21/46, 11/4/46, and 9/24/51.

<sup>39</sup>*BT* 12/25/50, 11/4/46, 10/21/46, 11/18/46, 4/5/48, 8/9/48 (quote), and 9/17/51. On price controls and World War II, see Gene Smiley, *Rethinking the Great Depression* (Chicago: Ivan R. Dee, 2002), pp. 142–47.

hog or poultry raisers with more expensive feed. And like most government controls, the farm program inevitably bred corruption and preferential treatment, since “arbitrary quotas must breed lobbies.” Hazlitt summarized the process in a July 1962 piece examining the sugar and cotton quota system:

The government, say, guarantees farmers higher prices for certain crops than they could get in a free competitive market. As a result it finds that it has encouraged huge surpluses. To prevent these it limits the number of acres on which each farmer is permitted to grow the subsidized crops. But these privileged acres then sell for enormously higher prices than those on which the subsidized crops are forbidden. So what happens when someone stands to win or lose millions of dollars, depending on the discretionary decision of some petty bureaucrat...? The result is the most inevitable consequence of substituting discretionary favoritism for the rule of law. One of the worst consequences of “government economic planning” all over the world has been the corruption of the civil service.<sup>40</sup>

When viewed in the wake of the 2008 financial crisis, Hazlitt’s columns on credit control make for some particularly eye-opening reading. During the fifties, he attributed the rapid growth of consumer credit to the Federal Reserve’s failure to maintain interest rates at appropriate levels. Rather than clamp down on the total supply of credit, the government chose instead to substitute “bureaucratic judgment and favoritism for the judgment of the marketplace,” setting limits and conditions on specific types of installment credit used to purchase consumer durables or obtain margin loans for corporate securities. Yet, he observed in 1956, “the same government that fears the too-rapid growth of installment credit, even when financed by private lenders at their own risk, has promoted an enormous housing boom by

itself guaranteeing mortgages on shoestring margins that make the installment credit terms of automobiles or television sets look like the acme of conservatism.” It came as no surprise, he mused, that government-backed lenders lacked the incentive to assess a borrower’s fitness or integrity, when the money they stood to lose belonged not to them, but to taxpayers. Hazlitt spoke here specifically regarding the veterans mortgage program, but his Eisenhower-era lament echoes still, with haunting prescience, amidst the modern ruins of Fannie and Freddie: “What sort of government policy is it that encourages families to assume debts beyond their resources? [. . .] The only real remedy is not for Congress to ‘set up more safeguards,’ but to get the government out of the lending business.”<sup>41</sup>

### LABOR POLICY AND UNIONS

Hazlitt ranked federal labor policy as the most pernicious of the various forms of economic control, because he believed that state-sponsored efforts to fix the price of work cut to the heart of Keynesian purchasing power and full-employment fallacies. The collective bargaining regime created by the 1935 National Labor Relations Act established organized labor as a “countervailing force” in the industrial marketplace to balance the considerable influence traditionally wielded by corporate management. Given that over the past six decades, the federal government had aligned itself more or less consistently against the trade union movement, this leveling of the playing field under force of law represented one of the most consequential of Roosevelt’s reform efforts—not least because it cemented a permanent electoral alliance between unions and the Democratic Party.<sup>42</sup>

According to Hazlitt, the inevitable politicization of wage setting under the Wagner Act took on a Keynesian patina once Democrats accepted that “higher wage rates under no matter what circumstances increase the income of labor and increase prosperity by increasing labor’s ‘purchasing power.’” Under

<sup>40</sup>On rent control, see *BT* 12/2/46, 1/27/47, 12/29/47, 2/2/48, 3/14/49, 4/3/50, 5/15/50, 7/24/50, 5/28/51, and a chapter added in later editions of *Economics in One Lesson*, pp. 127–33. On “guideposts,” see *BT* 10/31//61, 5/14/62, 5/28/62, 4/29/63, 5/6/63, 12/6/65, 6/6/66, 8/1/66. On exchange controls, see *BT* 8/20/56, 10/22/56, 3/13/61, 8/5/63, 8/12/63, 10/28/63, 2/17/64, and 5/4/64. On parity, see *BT* 7/23/62 (quote), 5/21/51, 4/23/56, 1/30/56, and 6/22/59.

<sup>41</sup>*BT* 11/15/54, 8/29/55 (quote), 2/13/56 (quote), 3/5/56 and 2/4/57.

<sup>42</sup>Eric Rauchway, *The Great Depression and the New Deal: A Very Short Introduction* (New York: Oxford University Press, 2008), pp. 84–96; Anthony J. Badger, *The New Deal: The Depression Years, 1933–1940* (New York: Hill and Wang, 1989), pp. 118–46, 245–98; David M. Kennedy, *Freedom From Fear: The American People in Depression and War, 1929–1945* (New York: Oxford University Press, 1999), pp. 288–322; Melvin Dubofsky, *The State and Labor in Modern America* (Chapel Hill: University of North Carolina Press, 1994), pp. 1–167.



normal conditions, if government-facilitated contracts imposed hourly wages exceeding marginal worker productivity, production costs would increase, the volume of sales and gross income would fall, and unemployment would rise, since most overpriced commodities, including labor, remain unsold—unless the money supply expanded as well. In that case, an unstable prosperity could be maintained as long as prices kept ahead of wages, that is, as long as union labor acceded to falling real income.<sup>43</sup>

But unions had grown sophisticated and sensitive to any decline in real wages. Rather than fall for the “money illusion,” Hazlitt suggested, they would demand wage increases (automatic or otherwise) to compensate for inflation. Since inflationary policies work only through stealth (as soon as consumers or lenders become aware of inflation, they hedge against it) the result would be a wage-price spiral supported by ever-larger volumes of depreciating currency. Under such conditions, unemployment could co-exist with inflation (stagflation) if wages managed to exceed prices; eventually the entire edifice would collapse.<sup>44</sup>

<sup>43</sup>BT 8/22/49 (quote). On high labor costs and unemployment during recessions, see BT 8/1/49 and 4/24/50. In the latter column, Hazlitt noted the similarity between price fixing in the agricultural and labor markets, where taxpayers end up subsidizing unsold surplus in silos and via unemployment benefits.

<sup>44</sup>On inflation, see BT 5/21/56, 6/11/56, 3/21/57, 11/4/57, 7/15/57, 1/20/58, 3/6/61, and 12/17/62. Hazlitt’s analysis here overlaps with that of German economist (and Keynesian critic) L. Albert Hahn. See *The Economics of Illusion* (New York: Squier Publishing, 1949), pp. 49–62, 119–45, 166–84, and *Common Sense Economics* (London: Abelard-Schuman Limited, 1956). Hazlitt lauded both books, and wrote the introduction to the former; see BT 3/4/57. Hazlitt believed Keynes confused wage rates with wage income. Reducing wage rates could actually increase aggregate income if rate reductions led to an increase in the number of workers employed (See *The Failure of the New Economics*, pp. 267–69). For Hazlitt, downward wage revisions remained the primary means to correct economic downturns. He believed Keynes erred in thinking equilibrium was possible with unemployment. Rather than equilibrium, the situation Keynes was actually describing was “merely frozen, such as prolonged mass unemployment because of a prolonged maladjustment between prices of different commodities, or between individual wage rates, or most often between prices and wage rates” (*Failure*, p. 54). Keynes’s focus on aggregates such as “the wage level” or “price level” led him to overlook constant shifts in relative prices and wages: “Keynes remained blind to the most glaring fact in real economic life—that prices and wage *never* (except perhaps in a totalitarian state) change

Excessive wages acted to raise prices for consumers and thus reduce the real purchasing power of all other (non-union) workers, Hazlitt argued. Indeed, Hazlitt was at pains to demonstrate that the wages and benefits secured by the most influential unions in major industries like automobiles and steel routinely outpaced the cost of living by significant margins. But by increasing the costs of production, they also reduced corporate profits. Without profits for capital investment, companies could not purchase the machinery that increased worker productivity—the only non-inflationary method to raise wage rates. Indeed, the “fetish” of full employment obscured this connection between maximum production and efficiency. Even the most primitive or tyrannical societies employed everyone, he observed; only free-market systems fostered the innovation necessary to get the most production with the least labor, the hallmark of economic progress. The best way to bring about enduring “full employment,” Hazlitt concluded, was “to provide a stable currency, and to keep prices, wages, and interest rates free, competitive, and flexible, so that a workable dynamic relationship can be constantly maintained between one price and another, one wage and another, between prices and costs, prices and wages, payrolls and profits.”<sup>45</sup>

The transformation of the political economy of labor under the New Deal state militated against such free-market alternatives, Hazlitt believed, because it had institutionalized inflationary wage demands that employers had little recourse to refuse. In addition to the Wagner Act, he could point to the expansion of minimum wage provisions through successive amendments to the 1938 Fair Labor Standards Act or via the 1936 Walsh-Healy Act, which covered federal contractors. Related rules for overtime pay, he added, tended to penalize employers offering the highest wages and reward the best-paid workers disproportionately. Again, Hazlitt credited a combination of capital investment, improved production technology, and market competition for driving marginal labor productivity and the general wage level steadily upward over time. If the reformers were right and causation lay elsewhere, he noted, then even the poorest of nations could create

*uniformly* or as a *unit*, but always ‘relatively’” (*Failure*, pp. 20–31, quote, 27).

<sup>45</sup>BT 9/12/55 (quote); On full employment, see BT 1/6/47, 9/1/47, 11/27/50, and 5/7/51; *Economics in One Lesson*, pp. 71–73; *The Failure of the New Economics*, 399–408; on purchasing power, see BT 1/27/47, 9/1/47, 8/15/49, 9/1/47, and 12/28/48. On productivity, profits, and wages, see BT 2/11/52, 3/22/54, and 7/16/56.

prosperity at any time by legislative fiat or through “bargaining.”<sup>46</sup>

Not even the 1947 Taft-Hartley Act gave Hazlitt reason for hope. Taft-Hartley emerged as the conservative counterweight to the Wagner regime, the product of a Republican-dominated 80th Congress elected in 1946 in response to post-war inflation, excessive government controls, and historic levels of labor strife. Passed by an alliance of anti-labor Republicans and Southern Democrats, Taft-Hartley did not roll back, so much as circumscribe, New Deal labor law. It retained the process of collective bargaining supervised by the National Labor Relations Board, but outlawed wildcat strikes, secondary boycotts, and the closed shop. It prohibited both management *and labor* from engaging in “practices which [sic] jeopardize the public health, safety, or interest” and required anti-communist affidavits from all unionists. Moreover, it authorized the president to intervene in strikes that threatened national security and enabled individual states to pass “right-to-work” laws outlawing exclusive union shops.<sup>47</sup>

Despite his initial optimism, however, by 1949 Hazlitt began calling for Taft-Hartley’s repeal, judging it equally guilty of rigging the system against business owners. Both Wagner and Taft-Hartley forced employers to negotiate exclusively with industry-wide unions, granting the latter effective monopoly power denied to other associations or corporate entities. Neither spelled out what good faith collective bargaining actually meant. What it amounted to in practice, according to Hazlitt, was relentless pressure on employers to concede to union demands and on workers to join unions whether they wanted to or not. “The right to strike does not necessarily imply the right to win a strike, and the right to quit work does not imply the right to prevent others from working,” he emphasized.<sup>48</sup>

<sup>46</sup>For a representative sample of columns covering minimum wage issues, see *BT* 2/7/49, 1/17/55, 6/17/55, 8/8/55, 8/22/55, 7/23/56, 12/3/56, 3/20/61, 4/24/61, 2/3/64, 4/6/64, 7/6/64, and 4/11/66.

<sup>47</sup>Dubofsky, *The State and Labor in Modern America*, pp. 197–208. Hazlitt reviews the provisions of Taft-Hartley in *BT* 6/30/47. Oddly, he makes no mention in this column of Section 14(b), the right-to-work provision. By enabling Sunbelt states to outlaw exclusive union shops, it prevented the union movement from gaining a foothold there, a critical factor in the region’s—and the nation’s—postwar economic development. Hazlitt does mention 14(b) much later on (*BT* 6/7/65), but again seems to elide its significance.

<sup>48</sup>On Taft-Hartley, see *BT* 4/12/48, 12/27/48, 5/2/49, 5/16/49, 10/26/49, 12/21/53 (quote), 2/27/56 (on monopoly), and 12/30/57. See also *BT* 11/25/46. Hazlitt resented

Hazlitt judged that American labor law had removed all the risk associated with striking, and with it any incentive for labor representatives to bargain in good faith. Contrary to the expectations of lawmakers, the guarantee of federally supervised collective bargaining did not usher in a new era of industrial peace. The period between the late forties and the early seventies saw the most frequent and contentious series of work stoppages in the twentieth century, averaging 352 major events annually in the fifties and 285 per year over the next two decades. The steel industry alone was convulsed by national strikes in 1946, 1949, 1952, 1956, and 1959.<sup>49</sup>

When the collective bargaining process broke down in an industrial dispute with national security implications, presidents frequently convened independent fact-finding commissions to arbitrate an equitable solution. As documented in “Business Tides,” however, such recourse to “neutral” experts invariably produced recommendations that ratified the most inflationary union demands for wages and benefits. The 1926 Railway Labor Act created the template in an effort to deter debilitating railroad strikes, but FDR and Truman employed similar boards to deal with coal and steel stoppages as well. “If government boards know how to set steel wages, then they know how to set all wages and prices,” Hazlitt opined during the 1949 steel strike. Of course, no board could know for certain how much a given wage increase stood to affect company profits, prices, or competitiveness, even if it acted with complete objectivity “and not, as in the past, merely to buy off a strike, or to hold the labor vote, or to pay a political debt.” Indeed, stated commitments to wage stability usually evaporated, as they did during the Korean War, when Truman’s Wage Stabilization Board recommended that striking steel workers receive an 11 percent increase despite the fact that their wages, among the highest in the country, outstripped the cost of living. Industry efforts to compensate with a 5 percent price increase, however, provoked denunciations from the administration. De-linking wages and prices in this way created an ingrained double standard that, Hazlitt contended, squeezed employers in a Keynesian vice. In

Eisenhower’s “pox on both their houses” approach to labor disputes: “It is inconsistent for the government to ask unions to refrain from higher wage demands while it retains a network of federal statutes which make[s] it almost impossible for employers to refuse to yield to higher wage demands.” See *BT* 3/21/57.

<sup>49</sup>Nelson Lichtenstein, *State of the Union: A Century of American Labor* (Princeton, N.J.: Princeton University Press, 2002), p. 136.

practice, “wage stabilization” served as little more than “a political effort at redistribution of income.”<sup>50</sup>

As a last resort, presidents faced with a prolonged strike jeopardizing national security could opt to seize the industry in question and operate it under government auspices. Truman did so with the railroads (1946) and steel (1952), and his threat to take over the coal industry in 1950 forced mine operators to accept the recommendations of federal arbitrators. Hazlitt decried this nuclear option as an assault on property rights and an exercise in blaming the victim, one that stretched the bounds of constitutionality (the Supreme Court agreed in 1952) and effectiveness. “Mr. Truman seems to have forgotten entirely that even when he seized the railroads in May of 1946 he did not end the strike that had been declared against the generous wage decision of his own fact-finding board,” he noted during the dust-up over coal. “On that occasion Mr. Truman was finally reduced to proposing that he be given the totalitarian power to throw the strikers into the Army and force them to run the trains that way.” Yet none of this dampened President Kennedy’s desire in 1961 for enhanced authority to conduct labor relations, including stronger seizure laws and more vigorous fact-finding boards whose new powers, Hazlitt feared, would amount to compulsory arbitration and wage fixing.<sup>51</sup>

Ironically, by the early sixties such demands reflected concerns within the Kennedy White House that unions had grown powerful enough to “demand and get excessively high wage rates . . . that would force more inflation, price us out of foreign markets, imperil the dollar [and] bring unemployment.” This shift in perspective, even among establishment liberals, reflected broader changes in how Americans perceived the role of labor unions in national economic life after 1957–58. Ever a persistent critic, Hazlitt approached labor affairs with a renewed sense of urgency around this time.<sup>52</sup>

Two notable trends upended labor’s fortunes after 1957. First, the serious recession that began that year underscored the onset of urban deindustrialization, particularly in the “Rustbelt” states bordering the Great Lakes and extending throughout the Northeastern, Mid-Atlantic and Midwestern regions. Whereas the industrial base in this area managed to absorb the higher

production costs and discord that accompanied union activism in the forties and fifties, the high demand and lack of competition that characterized those years could not be sustained indefinitely. Hazlitt had long warned that exorbitant, inflation-indexed union wages and fringe benefits threatened to price American companies out of an increasingly competitive global market. His extensive coverage of the great 1959 steel strike represented the culmination of this argument. Though a conflict over shop floor rules precipitated the walk-out, Hazlitt chose to emphasize, as always, the ruinous implications of union wage demands on employment and competitiveness. As it turned out, the strike paralyzed the American Steel industry for 116 days and marked the beginning of its permanent decline, as cheaper imports from more efficient foreign forges filled the gap for domestic manufacturers.<sup>53</sup>

The second blow to labor’s prestige came in the form of congressional committee hearings on union corruption and criminality, chaired by Arkansas Senator John McClellan in 1957. Though a majority of committee members hailed from right-to-work states the evidence linking prominent unions like the Teamsters to organized crime and racketeering proved hard for anyone to ignore. The hearings tarnished the moral standing of labor and induced Congress to pass the 1959 Landrum-Griffin Act, which instituted tighter restrictions on secondary boycotts and stricter regulations of union financial dealings.<sup>54</sup>

Around this time, the emphasis in Hazlitt’s labor columns shifted from the structural flaws of the collective bargaining process under Wagner/Taft Hartley to the endemic problem of labor violence enabled by the 1932 Norris-LaGuardia Act. The Act barred federal courts from issuing injunctions to halt “nonviolent” labor disputes. But in so doing, Hazlitt maintained, it removed the primary instrument for preventing the intimidation and coercion routinely associated with mass picketing, made replacement of striking workers nearly impossible, and left the Federal government with no means of policing local strikes or preventing violence. The Taft-Hartley Act was “practically blind to the existence of such matters,” while ambiguous federal court decisions left the power of states and localities to respond in doubt. Hazlitt never denied the right of workers to strike peaceably, but the cultural animus

<sup>50</sup>On arbitration boards, see *BT* 12/9/46, 5/17/48, 8/29/49, 2/11/52, 4/7/52 (quote), 6/2/52, 8/11/52, and 8/18/53. For the Kennedy administration and steel, see *BT* 4/30/62 and 5/21/62.

<sup>51</sup>On seizure power, see *BT* 3/20/50 (quote), 5/12/52, 5/19/52, 6/16/52, and 7/31/61.

<sup>52</sup>*BT* 4/9/62 (quote).

<sup>53</sup>Lichtenstein, pp. 124, 162. On recession, wages, and unemployment, see *BT* 4/7/58. On the Steel Strike, see *BT* 7/27/59, 8/3/59, 8/17/59, 8/24/59, 8/31/59, 9/7/59, 10/26/59, 11/2/59, 11/9/59, 11/23/59, 12/28/59, 1/4/60, 1/18/60, and 1/25/60.

<sup>54</sup>Lichtenstein, pp. 162–66.



against strike-breaking nourished by Norris-LaGuardia and other labor laws meant that “if no strike can ever be broken, the strikers must always win, no matter how extravagant their final demands, and more and more strikes, with consequent economic paralysis, must be encouraged and rewarded.”<sup>55</sup>

In developing his extended critique of how state-sanctioned labor violence and intimidation eroded the rights of employers and workers alike, Hazlitt drew upon the research of Sylvester Petro, a libertarian legal scholar and longtime admirer of Mises. Petro’s publications included a summary of the McClellan hearings, *Power Unlimited: The Corruption of Union Leadership*, and tracts such as *The Kohler Strike: Union Violence and Administrative Law* and *The Labor Policy of the Free Society*, where he promoted “free employee choice” as the central principle in American labor law. Like Hazlitt, he recommended repealing Norris-LaGuardia, Wagner, and Taft-Hartley, abandoning labor boards, outlawing mass picketing and all forms of violence and coercion by either side, and insuring all individual workers and employers enjoyed the right to “free bargaining,” that is, the freedom to engage whatever collective bargaining unit they chose, rather than limiting the choice to a single, state-approved, industry-wide union.<sup>56</sup>

<sup>55</sup>On union violence and Norris-LaGuardia, see BT 12/13/54, 5/16/55 (quote), 2/23/59, 5/4/59, 5/18/59, 7/27/59, 9/7/59 (quote), and 8/29/66.

<sup>56</sup>Hazlitt cites or mentions Petro in BT 6/2/58, 10/6/58, 2/23/59, 5/4/59, 10/12/59, 4/4/60, 7/10/61, 4/8/63, 9/21/64, and 6/7/65. See also *The Labor Policy of the Free Society* (New York: Ronald Press, 1957); *Power Unlimited: The Corruption of Union Leadership* (New York: Ronald Press, 1959); *The Kohler Strike: Union Violence and Administrative Law* (Belmont, Mass.: American Opinion, 1961), and BT 11/2/59 (free collective bargaining). Hazlitt worried that ham-handed government efforts to address the violence government policies fostered only curtailed freedom further. These included the Taft-Hartley Act’s overly broad emergency injunction provision, which ordered all strikers back to their jobs during an 80-day cooling off period. Traditional court injunctions exerted more limited authority, requiring strikers to desist from violence and other unlawful interference with the rights of others. Not only did the cooling off period victimize strikers, however, it did little to help employers. When Eisenhower invoked it during the 1959 steel strike, Hazlitt believed it ratcheted up the pressure on the steelmakers to settle. Of course, when the 80 days expired, strikers were free to resume mass picketing and other forms of intimidation. See BT 10/26/59. Hazlitt described his proposal for labor peace as “a simple provision, enforceable in the courts, that an employer substantially engaged in interstate commerce could not discriminate in hiring or firing either

“Not until private coercion is prevented can personal liberty be secure,” Hazlitt insisted. He reaffirmed this principle and deplored the fruits of violence in a series of columns between 1959 and 1966 covering a multitude of work stoppages beyond the steel industry. These included the New York newspaper deliver strike (1/29/59); the New York hospital strike (6/8/59); the meatpackers strike (12/28/59); the Kohler strike (9/12/60); the Pennsylvania Railroad strike (9/19/60); the New York Printers Union strike (12/24/62); the dockworkers strike (1/21/63, 2/25/63); the national railway strike (9/16/63); the New York newspapers strike (10/11/65); the New York transit strike (1/31/66); and the airline mechanics strike (8/15/66). In a number of these pieces, Hazlitt also critiqued union efforts to maintain featherbedding shop floor rules that shortened hours or maintained sinecures for obsolete workers in the face of capital expansion. The long-held economic fallacy that machines immiserated workers rather than emancipated them, he observed, lay at the root of these endeavors.<sup>57</sup>

#### TAX POLICY

Liberal labor and welfare policies were designed to stimulate a “propensity to consume” that supposedly grew more tenuous as aggregate income increased. Hazlitt, however, faulted Keynesian theory for neglecting and undermining the more critical propensities to work, save, and invest. Specifically, he judged the punitive post-war tax rates assessed on corporations and the wealthy as further evidence that Keynesians wished to transfer the impetus and initiative for capital investment from the private sector to the public sector.<sup>58</sup>

World War II compelled a transformation of the American tax code. Since its inception in 1913 until 1940, the federal income tax had applied, at most, to 6 percent of the population, exempting all but the wealthiest tiers. Such a peripheral, class-targeted approach, however, could not begin to shoulder the fiscal demands of global war. Accordingly, the Revenue Acts of 1942 and 1943 created a system of “mass” taxation that broadened eligibility across all incomes, imposed a more steeply progressive rate structure topping out at 90

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against union members or against non-union members.” He also defended industry wide unions and their right to freedom of association against suggestions on the part of some conservatives that they be outlawed. See BT 1/9/59.

<sup>57</sup>Quote: BT 11/23/59. On featherbedding, see *Economics in One Lesson*, pp. 49–60 and BT 3/5/62, and 6/11/62.

<sup>58</sup>For a critique of the “propensity to consume,” see BT 5/21/56 and 6/11/56, and *The Failure of the New Economics*, pp. 98–134.

percent, and introduced withholding to collect income at the source. The number of taxpayers grew from just under 4 million in 1939 to nearly 43 million by 1945, while tax revenue ballooned from \$2.2 billion to \$35 billion (\$19 billion personal, \$16 billion corporate) during that same period. The onset of the Cold War kept rates high, although a bevy of deductions and loopholes mitigated the burden somewhat. In short, mass taxation became a permanent feature of American life. It enabled the growth of the post-war state, as the federal government came to dominate the nation's revenue system, collecting over half of all taxes by 1950. And it provided Keynesians with a more precise instrument with which to implement countercyclical budgeting.<sup>59</sup>

The hundred or so "Business Tides" columns on specific tax issues rank among the most technical Hazlitt wrote. They are difficult to summarize easily or in brief. One in particular, however, published on March 30, 1953 and reprinted in *Readers' Digest*, neatly captures his overarching approach to the matter. In it, Hazlitt recounts a conversation with a friend who tried to figure out how much he needed to earn under the current tax code to pay a recent \$100 plumbing bill. Since the friend qualified for the top bracket, he calculated that \$1,000 in dividends from his General Motors stock would leave him with \$100 after the 90 percent tax bite. To generate those dividends, however, GM had to earn over \$4,000 before taxes, meaning it needed to move more than \$21,000 worth of its product to dealer showrooms. In sum, to pay the plumber his \$100 required GM to sell 18 Chevrolets. In recounting this tale, Hazlitt did not seek to drum up sympathy for the wealthy so much as draw attention to the impact of the tax burden on the productive capacity of the economy. When the government took, on average, 57 percent of yearly corporate earnings and wrung "42 times as much out of the average corporation as the investor in the top income-tax bracket is allowed to get and keep," it threatened to dry up the capital investment needed to maintain wages, employment, and production.<sup>60</sup>

Despite his steady drumbeat for cuts in federal expenditures, Hazlitt demonstrated a willingness to

forego balanced budgets temporarily in exchange for significant tax reform. In many respects, his formula conformed to that later associated with supply-side economics, emphasizing significant, permanent reductions in the top personal and corporate tax rates as well as in the overall number of brackets, cuts in the capital gains tax, elimination of the effective double taxation of dividends, and more generous depreciation allowances. He sought above all to alter the incentive structure of the tax system to promote more savings and capital investment among society's most productive actors, rather than to make that system more "fair."<sup>61</sup>

Indeed, Hazlitt was wont to reject broader tax reductions in the lower brackets. He decried several Democratic efforts during the Truman and Eisenhower eras, for example, to increase personal exemptions across the board, which he feared would remove millions of Americans from the rolls and severely inflate the federal deficit. On the one hand, releasing so many Americans from a tax obligation effectively cut the connection between expenditures and taxes, breeding fiscal irresponsibility among those who assumed "the wealthy" would pick up the bill for a profligate welfare state. But the hard fact remained that the bulk of tax revenue came from the base of the pyramid (below the 20 percent rate), not the apex. "Cutting taxes on low incomes, at the cost of a huge budget deficit, will not increase the purchasing power of low-income groups," he insisted, "for if the deficit is financed by borrowing from the banks and increasing the money supply . . . it will create inflation"—the most regressive of all taxes—driving up prices and eviscerating purchasing power.<sup>62</sup>

For these reasons, Hazlitt opposed the Kennedy-Johnson tax reform bill, which, he felt, cut taxes too much in the lower brackets and too little in the upper (while monetary policy was kept far too loose). The result was an \$11 billion deficit—a tax cut financed through borrowing and inflation. Recent scholarship has made an intriguing case that the logic driving the landmark

<sup>59</sup>W. Elliot Brownlee, "Tax Regimes, National Crisis, and State-Building," in W. Elliot Brownlee, ed. *Funding the Modern American State, 1941–1995: The Rise and Fall of the Era of Easy Finance* (Cambridge: Cambridge University Press, 1996), pp. 92–93; Julian E. Zelizer, *Taxing America: Wilbur D. Mills, Congress, and the State, 1945–1975* (Cambridge: Cambridge University Press, 1998), pp. 82–90.

<sup>60</sup>Hazlitt did not spell out how deductions, exemptions, and loopholes may have shielded wealthy and corporate taxpayers. See Zelizer, *Taxing America*, pp. 88–96.

<sup>61</sup>On profits and employment, see *BT* 10/27/47, 12/27/48, 8/6/51, 7/23/56, 6/24/57, 1/20/58, 12/11/61, 4/30/62, 5/7/62, 6/18/62, 7/29/63, 2/3/64, and 5/23/66. On incentives and supply side leanings, see *BT* 4/7/47, 3/22/48, 9/14/53, 4/5/53, 4/26/54, 3/14/55, 3/25/57, 6/24/57, 8/7/61, 8/14/61, 12/18/61, 6/25/62, 9/3/62, 11/26/62, 12/3/62, 1/14/63, 5/27/63, and 7/1/63. For a primer on supply-side economics, see Brian Domitrovic, *Econoclasts: The Rebels who Sparked the Supply Side Revolution and Restored American Prosperity* (Wilmington, Del.: ISI Books, 2009).

<sup>62</sup>*BT* 3/23/59 (quote). On deficits and taxes, see *BT* 3/4/54, 3/29/54, 10/10/55, 6/17/57, 2/24/58, 7/2/62, 3/4/63, and 3/15/65.

1964 tax reduction—which reduced rates from 91 percent to 70 percent at the top of the pyramid and from 20 percent to 14 percent at the base—derived more from the supply-side theories of Robert Mundell than the Keynesian orthodoxy within the Council of Economic Advisors. Historians and economists will continue to debate the origins of the policy, but for his part, Hazlitt sensed Keynesianism afoot. As he wrote on March 9, 1964, “the Administration’s pressure for the \$11.5 billion tax cut just enacted may be cynically ascribed to an effort to win the coming election. But it is also supported by an economic theory, a theory now widely and sincerely held. . . . It is a pure ‘demand theory.’ It assumes that, whenever there is recession or unemployment, the reason must be ‘insufficient demand.’”<sup>63</sup>

### BRETTON WOODS AND FOREIGN AID

Henry Hazlitt never considered extensive domestic travel a prerequisite for composing “Business Tides.” With few exceptions, like a trip to the Texas cattle country in 1948, he filed his nationally oriented columns from New York, the nation’s (and the world’s) financial capital. He adopted a considerably more peripatetic approach, however, when addressing international economic affairs, something he did quite frequently during his tenure at *Newsweek*. Nearly every summer, bylines from London, Paris, Berlin, Madrid, Stockholm, Zurich, Brussels, or Amsterdam announced that Hazlitt was abroad. As he recalled years later, the challenges of roving journalism proved exhilarating, if exhausting:

I had to start interviewing people on my first day, usually a Monday. I would typically begin with the economics officer at the American Embassy and would get further “leads” from him among the informed economists and businessmen of the country. I would try to finish up my fact collecting by Friday morning, and start my column, filing it late Friday or early Saturday. Sunday would often be my day for a plane to the next country. I do not remember that I ever failed to fulfill this schedule.<sup>64</sup>

<sup>63</sup>On the JFK/LBJ tax cut, see Zelizer, *Taxing America*, pp. 179–211. For Hazlitt’s criticism, see *BT* 2/18/63, 4/15/63, 6/3/63, 9/2/63, 12/30/63, 1/20/64, 2/24/64, 3/9/64, 3/16/64, 4/25/66, and 6/20/66. For supply-side revisionism, see Domitrovic, *Econoclasts*, pp. 70–75. Despite their differences in interpretation, Domitrovic considers Hazlitt to be “the greatest economic commentator of the century” (p. 54).

<sup>64</sup>Hazlitt, “My Life and Conclusions,” pp. 56–57.

Whether written out of his office or his suitcase, Hazlitt’s analysis of world economic problems garnered an engaged and influential foreign readership consisting predominantly of Europeans and Americans abroad (although his following in Latin America was also significant). He estimated that the version of his column published in *Newsweek*’s international edition generated about 25 percent of his mail, even though it reached the equivalent of only 5 percent of the domestic circulation. Public figures like Chancellor Ludwig Erhard of West Germany and Reinhard Kamitz, President of the National Bank of Austria, counted among his readers. The BBC thought enough of his reputation to make his ruminations on the British budget the subject of a transatlantic broadcast. For this international audience, Hazlitt projected his domestic concerns about inflation, Keynesian theory, statist controls, and the welfare state on a global scale, dissenting once more from the conventional wisdom informing economic policy after 1945.<sup>65</sup>

As Allied victory in World War II appeared more certain, western officials resolved to apply the lessons of the previous war’s aftermath to the process of post-war reconstruction. They envisioned a cooperative system designed to buttress global economic interdependence. It would prevent a collapse of finance and trade by discouraging autarky: the competitive currency devaluations, high tariff walls, and like policies that had aborted post-war recovery in the twenties and brought about worldwide depression in the thirties. The most influential architects of the Bretton Woods agreement, however, including John Maynard Keynes and Harry Dexter White, determined not to sacrifice the well-being of domestic economies upon the altar of stable currencies. The institutions they helped create at the 1944 Bretton Woods Conference, including the International Monetary Fund (IMF) and World Bank, were designed to maintain liquidity and adjust imbalances in trade payments without dampening the flow of goods or capital, but also without disturbing domestic prices or inducing unemployment.

The Bretton Woods agreement as enacted required the United States to serve as a world economic hegemon. The U.S. offered its own currency as a global reserve that provided the peg for a system of fixed international exchange rates, tying all other currencies to the dollar and the dollar to gold at \$35 per ounce, making it convertible upon demand of central banks. The United

<sup>65</sup>Hazlitt to Osborn Elliot, 2 November 1963, Folder “Newsweek Contractual Agreements,” Box B04, Subject Files, Henry Hazlitt Archives; “For Your Information,” p. 1.



States also provided a massive influx of capital to jump-start European recovery. The severity of the problem seemed clear in the summer of 1947, when Great Britain reneged on its loan agreement with the United States and suspended convertibility of the pound in order to stop the hemorrhage of dollar resources from British banks. Meanwhile, Germany's own economic dislocation disrupted critical supplies of coal and other goods that Europe's industrial base and civilian population required. The Marshall Plan formed the lynchpin of the subsequent American rescue effort, funneling billions of dollars overseas to rebuild the infrastructure of Western Europe. In the context of the emerging Cold War conflict with the Soviet Union, American officials interpreted such economic aid, in combination with billions more in direct military assistance, as the critical pillars supporting the global containment of communism, a commitment that would extend beyond the immediate post-war crisis and the borders of Europe.<sup>66</sup>

Hazlitt viewed these trends with alarm, but not because he considered himself an "isolationist." Indeed, he bristled at the term, especially when used to delegitimize criticisms of prevailing policy. "Our own economic and political future will be deeply affected by the fate of Europe," Hazlitt confirmed in 1947, and "we should do anything we can that promises to increase Europe's welfare without imperiling our own." He approved of military alliances such as the 1949 Atlantic Pact, an unprecedented guarantee on the part of the United States to come to the direct aid of victims of Soviet aggression, and advocated economic engagement by the private sector. But Hazlitt's brand of conservative internationalism did not abide by the unsound and fallacious economics he saw informing much of U.S. foreign policy. He rejected the mantle of global hegemon if it meant the United States had to sacrifice its economic well-being by fronting for policies that bred

statism, autarky, and inflation at the expense of efficiency, production, and freedom.<sup>67</sup>

In brief, Hazlitt believed that American foreign aid, from the Marshall Plan on, perpetuated unsustainable financial practices on the part of foreign recipients, incentivized, in turn, by Bretton Woods's flawed system of international monetary "reform." He described the 1944 agreement as having abandoned a true gold standard for a Potemkin village. Behind the façade of the fixed dollar, individual governments were allowed to peg their currencies at "an artificial, arbitrary, and unreal valuation" supported not by a free, self-correcting price system but rather "police penalties" and state controls. They did so in concert with Keynesian prescriptions. Internal post-war politics within each nation dictated policies to maintain high wages, full employment, and consumer purchasing power, all of which required expanding supplies of money and credit. Under a true gold standard, such inflated currency would quickly lose value in international markets, but under IMF regulations governments had the obligation and the flexibility to preserve the "official" exchange value relative to the dollar. They accomplished this through exchange controls: forbidding citizens to buy and sell currency at the rate a free market would actually bear (black markets in currency usually reflected the difference). As a consequence, these artificial, official exchange rates tended to overvalue the pound, the franc, the lira, and the mark by a significant margin.<sup>68</sup>

Hazlitt blamed chronically overvalued currencies and other self-imposed state policies, rather than the devastation of war, for the post-war "dollar gap" that prompted the hue and cry for U.S. foreign assistance. Because overvalued currencies make foreign imported goods less expensive and domestic exports more so, they encourage trade deficits. British and French consumers shunned their own products for cheaper American ones, for example, and needed a constant supply of dollars to purchase them. But since exports pay for imports, a slowdown in the former led to a shortage of dollars to pay for the latter (of course, under free currency exchange, such a high demand for dollars would make them, and American goods, more expensive, altering consumer incentives accordingly). The problem, Hazlitt explained, was not a "dollar gap," but rather the simple fact that "Britain and Europe and Latin America wish

<sup>66</sup>On Bretton Woods, see Alfred Eckes, Jr., *A Search for Solvency: Bretton Woods and the International Monetary System, 1941–1971* (Austin: University of Texas Press, 1975) and Robert Solomon, *The International Monetary System, 1945–1981* (New York: Harper and Row, 1982). On the Marshall Plan, see Michael Hogan, *The Marshall Plan: America, Britain, and Reconstruction of Europe* (Cambridge: Cambridge University Press, 1987), Herman Van der Wee, *Prosperity and Upheaval: The World Economy 1945–1980* (London: Viking, 1986), and Melvyn Leffler, *A Preponderance of Power: National Security, The Truman Administration and the Cold War* (Stanford, Calif.: Stanford University Press, 1992).

<sup>67</sup>BT 11/3/47 (quote). For a broader analysis of "conservative internationalism, see Julian Zelizer, *The Arsenal of Democracy: The Politics of National Security from World War II to the War on Terrorism* (New York: Basic Books, 2010).

<sup>68</sup>BT 8/36/57 (quote), and 9/2/57.

to buy more from the United States than they sell to it. . . . They wish to buy more than they can afford to pay for. They are consuming more than they are producing.” The only permanent remedy involved an increase in their production or a reduction of their consumption. “As long as they do neither,” he observed, “they can only keep up the one-sided trade with us with the proceeds of our loans or gifts.”<sup>69</sup>

Meanwhile, a multiplicity of other controls exacerbated the imbalance. Price ceilings distorted and reduced production while concealing domestic inflation; various allocations and prohibitions paralyzed initiative; nationalization of industries, as in Britain, built in inefficiencies and increased budget deficits; confiscatory taxes dampened investment and incentive. Likewise, various import quotas, bilateral treaties, license requirements, export subsidies, and other internal restrictions did “far more to throttle two-way trade” than even America’s own unfortunate tariff walls. Hazlitt underscored the cumulative absurdity of these policies by imagining their effect on interstate commerce:

The 1947 per capita income of Mississippi was lower than that of Great Britain, Denmark, Sweden, or France. Yet Washington did not start rushing millions of dollars into Mississippi either to “halt Communism” there or to enable Mississippians to buy more goods from New York. But if Mississippi’s state government suddenly decreed that 50 cents in Mississippi was worth \$1 in New York; if it ordered its exporters to turn over all their dollars from sales to New York to the state government and accept only 50 cents apiece for them; and if Mississippi’s government then allotted the proceeds to its importers to enable them to buy every dollar’s worth of goods from New York at a cost to the importer of only 50 cents—then everybody in Mississippi would want to import from New York and nobody in Mississippi would be crazy enough to export to New York. Mississippi would immediately have an unfavorable

balance of trade and an appalling shortage of New York dollars.

Ironically, Hazlitt observed, even as President Truman denounced critics of foreign aid as “isolationists,” the Marshall Plan’s Economic Cooperation Administration (ECA) subsidized autarkic policies that reduced American import levels and proved more deserving of the label. They left American consumers worse off, he lamented, while sticking American taxpayers with the tab for trade deficits and socialism abroad.<sup>70</sup>

Hazlitt recommended the lifting of exchange and other controls as the most direct cure for the world’s economic ills. Nations that did so, like Canada or West Germany under Ludwig Erhard and his advisor Wilhelm Röpke (acting against the wishes of American occupation officials), soon reaped the benefits. Those that did not resorted instead to a series of patchworks. “The most brilliant schemes of the planners today consist in tapering off their previous plans,” Hazlitt noted in 1950. These included reducing (but not eliminating) import quotas or, more commonly, adjusting currency exchange rates. While the Bretton Woods system meant to discourage competitive devaluations, it essentially encouraged corrective ones. France independently devalued the franc in February 1948; Britain slashed the official value of the pound from \$4.03 to \$2.80 in September 1949, and dozens of other nations soon followed suit. Within a year, Britain’s gold and dollar reserves more than doubled, and America’s own imports increased. Yet rather than throw off the yoke of controls entirely, most states chose to retain them in modified form. France, Hazlitt noted, continued to “fix the franc at an arbitrary official level,” tried to balance trade by “offering a 20 per cent subsidy on most exports and imposing a 20 per cent tax on imports,” and kept its economy “honeycombed with protections, subsidies, vast welfare programs, and rent, price, and wage controls.” He considered “managed” devaluations, rather than those dictated by the market, as “a confession of bankruptcy” and a “high-sounding euphemism for continuous currency debasement,” where bureaucrats unilaterally violated sovereign promises and habitually cheated creditors. As such, Hazlitt considered

<sup>69</sup>BT 8/18/47 (quote), 9/22/47, 5/10/48, 8/16/48, 10/6/47, 11/3/47 (quote), 8/16/48, 10/25/48, 12/6/48, 12/13/48, and 12/20/48. Hazlitt released a book on the Marshall Plan derived from his “Business Tides” columns on the subject entitled, *Will Dollars Save the World?* (New York: D. Appleton Century Company, 1947).

<sup>70</sup>On trade, see BT 6/26/50, 12/7/53, 4/12/54, and 3/28/49 (Mississippi). Of course, Hazlitt often condemned U.S. tariffs and trade quotas, particularly for agricultural products, as unfair and inefficient themselves. See BT 1/31/55, 10/24/55, 3/21/60, 7/25/60, 12/25/61, 1/29/62, 4/16/62, 6/4/62, 7/23/62, 3/19/62, and 10/28/63.



“automatic currencies based on gold” superior to “managed currencies based on guile.”<sup>71</sup>

While Hazlitt approved of U.S. security guarantees to western nations, he looked more skeptically upon efforts to bundle “military assistance” as an essential component of foreign aid. The House Committee on Foreign Affairs included one of the columns he wrote on the subject, “Why Foreign Arms Aid?” in its minority report on the 1954 Mutual Security Act. His argument echoed the concerns of prominent congressional conservatives, including Robert Taft (R-OH), a persistent critic of the national security state and Truman’s activist foreign policy. Any nation that had the will to defend itself likely had the means to do so as well, he assumed. Although exceptions occasionally arose, like Turkey, Greece, Iran, Korea, or Formosa, U.S. contributions earmarked for arms aid usually “released that much of the [recipient] governments’ own funds for other purposes,” including social security schemes, food subsidies, or paying the deficit on nationalized industries. At the very least, he suggested, Congress ought to deduct sums authorized for arms aid from foreign aid appropriations or the U.S. military budget. In the midst the Korean conflict and at the height of Cold War tensions, Hazlitt noted that Western European nations allocated roughly 5 percent of their national incomes and 18 percent of their government expenditures to defense. By comparison, even before the war over a third of the U.S. budget went for that purpose, even though the direct threat of Soviet aggression loomed larger for Europe. Like other forms of foreign aid, Hazlitt concluded, military assistance spared European nations from making zero-sum budgetary choices and ultimately subsidized profligate social welfare states.<sup>72</sup>

Part of Hazlitt’s unease with the Truman administration’s foreign and military aid proposals stemmed from their inherent potential for mission creep. Not only did future administrations expand the European component of these programs, they also followed Truman’s lead in targeting the Third World.

Indeed, by 1961, the United States had spent \$90 billion dollars in foreign aid, including \$60 billion in direct economic assistance to over 70 countries. Hazlitt hardly stood out as a lone voice of dissent. Foreign aid consistently ranked among the most controversial items on the political agenda, drawing fire from both the right and the left at different times for different reasons—indeed, on this subject Hazlitt managed to find common ground with both conservative representative Otto Passman (D-LA) and liberal Senator Wayne Morse (D-OR). Nevertheless, his dogged persistence stands out, as does the clarity of the economic case he presented.<sup>73</sup>

Hazlitt’s critique of Truman’s “Point Four” Program (later expanded into a 1950 pamphlet entitled, *Illusions of Point Four*) previews some of the arguments he would mount against aid to “developing” countries in the fifties and sixties, and mirrors other points of analysis directed at the original European aid program. Hazlitt was fond of noting that no country got rich by giving its exports away. “We are told that ‘three out of every four dollars’ in our foreign giveaway program ‘will be immediately spent within the United States,’” he recalled. “This is like trying to appeal to the self-interest of an automobile dealer by telling him that if he makes you a gift of \$4,000, you will use \$3,000 of it to buy one of his cars.” Likewise, resources “invested” by the government overseas merely diverted them from private domestic development. Foreign capital normally flowed to opportunities offering the highest returns or the lowest risk, but foreign aid bureaucrats had few incentives to make such distinctions, much like their colleagues overseeing subsidized domestic mortgages or educational loans. Of course, if the United States did decide to use its aid as a wedge to force internal economic reforms and render recipient nations more credit-worthy, it would likely generate ill will and anti-American sentiments that communists could exploit.<sup>74</sup>

<sup>71</sup>BT 2/9/48, 2/13/50 (quote), 10/23/50, 8/36/57 (quote), 10/3/49, 11/21/49 (quote). On German policy, see BT 2/23/48. Hazlitt admired Röpke and cited him often. See BT 11/3/47, 5/10/48, 12/20/48, 9/5/49, 11/27/50, 4/10/50, 9/20/56, 10/1/56, 11/17/58, 8/15/60, 11/12/62, 9/30/63, and 4/27/64. On the economic crisis of post-war Germany, see also John Zmirak, *Wilhelm Röpke: Swiss Localist, Global Economist* (Wilmington, Del.: ISI Books, 2001), pp.133–62 and Röpke, *Economics of the Free Society* (Chicago: Regnery, 1963).

<sup>72</sup>BT 7/12/48, 4/4/49, 5/30/49, 6/13/49, 5/12/50, 8/21/50, and 4/9/56; “For Your Information,” p. 1.

<sup>73</sup>BT 6/15/53 (“Why Foreign Arms Aid”), 4/3/61, 11/25/63 (Morse), and 4/26/65 (Passman); Hazlitt gives a brief history of foreign aid programs in BT 11/16/59. On foreign aid politics in Congress, see Robert David Johnson, *Congress and the Cold War* (New York: Cambridge University Press, 2006), pp. 69–104, 110–11, 126–28, 135–36.

<sup>74</sup>BT 4/17/50, 12/4/50, and 5/9/55 (quote). Even if the Point Four program were necessary, Hazlitt noted, its functions seemed to overlap with the International Bank for Reconstruction and Development and the Export-Import Bank. See also Henry Hazlitt, *Illusions of Point Four* (Irvington-Hudson, N.Y.: Foundation for Economic Education, 1950).

Yet, Hazlitt insisted, developing nations like India needed precisely such reforms to draw efficient capital and increase world production in ways that would benefit their populations. Charitable gifts intended to prevent starvation in such countries inevitably overlooked the fact that government policies, rather than acts of God, usually caused or exacerbated the crisis in the first place. “The argument that India cannot pay \$190,000,000 for grain because it has only “limited foreign exchange reserves” and an “unfavorable balance of payments” is economic nonsense,” Hazlitt noted in 1951. “These conditions are the result of the Nehru government’s own exchange control measures. It has made dollars scarce in the same way as it has made foodstuffs scarce—by putting artificial price ceilings on them.” What these nations needed was not hand-outs but “internal political stability, order, and good faith, and the adoption of policies calculated to attract the confidence rather than distrust of domestic as well as foreign private capital.” These included recognition and protection of property rights, freedom to withdraw earnings or principal, which would require dismantling exchange control, and the elimination of other “vexatious controls” such as “price-fixing, wage-fixing, and arbitrary profit limitation.” Hazlitt anticipated the arguments of contemporary economists like Hernando de Soto when he described capitalism as the “marriage of liberty and security,” where the rule of law worked to incentivize production and create wealth.<sup>75</sup>

Hazlitt did not hesitate to question other fundamental assumptions underlying the foreign aid program. Why, for example, was it suddenly considered “the duty of the American taxpayer ‘to promote welfare and growth for the peoples of Africa?’” Could U.S. aid actually achieve this goal? Did any demonstrable correlation exist between the level of aid provided to developing nations and their rates of economic growth? Moreover, if politicians belittled the cost of such programs to the taxpayer, did that mean that foreign aid dollars accounted only for “a similarly minute percentage of the total GNP of the hundred or so nations” receiving such aid? “How, then,” he asked, “could it substantially increase their living levels?” And was there any guarantee that aid recipients like Egypt, India, or

Yugoslavia would actually support U.S. national interests during an international crisis?<sup>76</sup>

In this vein, Hazlitt dared to revisit an even more fundamental supposition: “has our economic aid, scattered over nearly a hundred countries, done anything appreciably to arrest the spread of Communism?” Indeed, he doubted the essential premise that “poverty and despair” created a fertile breeding ground for indigenous communist movements, or that American aid served a vital function by lifting the standard of living high enough to ward off the threat. Again, U.S. officials had confused cause and effect. “It is not true that the nations of Europe are in danger of Communism today primarily because they have run into a series of economic crises,” he asserted. “They have run into these crises, rather, mainly because they have adopted monetary inflation, dictated economies, and socialistic controls which have destroyed the price mechanism and its incentives.” Anticipating modern debates concerning the motivations driving Islamic terrorism, Hazlitt believed the appeal of communism or other statist ideologies had an ideological rather than a material basis. “Germany went Nazi with less poverty, illiteracy, hunger, or disease than any country outside the United States,” he noted, while richer industrial districts tended to nurture more communist sympathies than poorer agricultural regions. Indeed, Communism and world income had advanced together. Military assistance may have slowed communist aggression in areas like Formosa or Vietnam. But in the end, Hazlitt wondered whether American foreign aid programs from the Marshall Plan on were “framed and administered as to save socialistic [nations] from Communism or . . . to save [them] from capitalism.”<sup>77</sup>

Hazlitt’s critical analysis remained consistent even as the global economic dilemma shifted from a dollar gap to a dollar glut, and U.S. policy makers grew increasingly concerned after 1957 about the drain of gold prompted by a worsening balance of payments deficit. It came as no surprise to Hazlitt that the burden of hegemony was beginning to weigh the U.S. economy down. The Bretton Woods system tied an anchor around the dollar, expecting it to hold its gold price firm

<sup>75</sup>BT 3/5/51, 7/30/51, and 7/7/52; Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2003). Hazlitt also suggested that foreign aid should not subsidize government-owned industrial and commercial enterprises, like Indian steel mills, that stood to compete with existing U.S. firms. See BT 7/8/63.

<sup>76</sup>BT 11/25/63 and 5/9/55. For contemporary critiques of foreign aid, see Dambisa Moyo, *Dead Aid: Why Aid Is Not Working and How There is a Better Way for Africa* (New York: Farrar, Straus, and Giroux, 2010) and William Easterly, *The White Man’s Burden: Why the West’s Efforts to Aid the Rest Have Done So Much Ill and So Little Good* (New York: Penguin, 2007).

<sup>77</sup>BT 12/15/47 (quote), 1/5/48 (quote), 5/9/55, 11/25/63, and 5/29/61.

while supporting all the other currencies that governments felt free to devalue at will (43 leading currencies depreciated between 1952 and 1962). At the same time, U.S. foreign aid programs flooded international markets with billions of dollars, inviting a trade imbalance. Likewise, the expense of those aid programs, coupled with unchecked domestic spending, exacerbated budget deficits and domestic inflation, fanned as well by loose Federal Reserve interest rate policies. These inflationary pressures acted to weaken a dollar that served as the lynchpin of the entire global monetary network.<sup>78</sup>

“What the United States faces today is only derivatively a ‘balance of payments’ crisis,” Hazlitt observed, “it is primarily a crisis of inflation.” Setting aside “the goods and dollars that we deliberately give away in foreign aid, payments always balance,” because foreign currency received in a sales transaction is eventually used to buy back goods from its country of origin. But, he noted, “if in return for the goods they sell to us, foreigners buy gold instead of other goods, it is because they think gold is the better bargain. They will think this as long as our commodity prices, as a result of domestic inflation, are too high as compared with the price at which we sell gold.” In other words, inflated money supplies, prices, and wage levels had turned the tables on the United States, making foreign imports cheap, domestic exports expensive, and gold—steady at \$35 an ounce since 1944—the best deal in town.<sup>79</sup>

Hazlitt emphasized that policies designed to discourage imports offered no solution to the balance of payments problem. The Kennedy and Johnson administrations attempted in various ways to reduce foreign investment, duty-free purchases, and similar commercial exchanges for foreign goods or services. But, he observed, “by the exact amount that we cut down our purchases from abroad, we ultimately cut down our sales abroad, by depriving foreigners of the dollar purchasing power to buy them.” Indeed, Washington’s crack-down on foreign investment made little sense given its magnanimous commitment to foreign aid. As Hazlitt surmised, “when we give away the dollars to buy part of our exports, we give away those exports. We cannot use the proceeds from those exports to buy our needed imports.” As such, they did little to bring about a trade balance, while retarding capital development and economic growth. Exports facilitated by foreign investment, however, were “real” because foreigners paid for them, and they helped to build “American economic strength.” Anyone worried about the negative effects

of foreign investment on the balance of payments, he concluded, “should doubly oppose foreign aid.”<sup>80</sup>

The American economy in the 1960s, with its booming growth and steady price levels, posed something of a dilemma for Hazlitt, who warned constantly of the dangers of inflated money and credit supplies. Where did this inflation manifest itself, then, if not in prices? The balance of payments problem pointed to the answer. “What has happened is that most of our inflation has been exported,” he maintained. “Broadly speaking, we have paid the cost of it, and Western Europe and the rest of the world have had the advantage of it.” Inflation led to the cumulative balance of payments deficit, precipitating “a massive movement of reserves to other countries from our own,” where they increased foreign money supplies, stimulated foreign economies, and employed foreign labor. Likewise, the International Monetary Fund always stood ready to lend to countries that ran up deficits, held down interest rates, and overvalued their currencies. The result, Hazlitt surmised, was an era of world inflation, a bubble waiting to burst.<sup>81</sup>

## GOLD

Hazlitt knew the Bretton Woods system was unsustainable in the long run—it collapsed in 1971 when President Nixon closed the gold window. But what did he offer as an alternative? Again, he bucked convention by following his mentor Mises and advocating a return to a true gold standard, where all currencies, not simply the dollar, were backed by gold reserves at a fixed ratio, freely convertible on demand by anyone into any other currency. Hazlitt wrote dozens of articles related to gold, particularly in the context of the balance of payments problem, but a series of four columns written in January 1954 best captures the essence of his argument. Requests poured in from across the country when *Newsweek’s* editors released them in booklet form, as they had with the series on inflation. And the Senate Banking and Currency Committee invited Hazlitt to testify

<sup>78</sup>BT 12/22/58, 10/31/60, 4/10/61, and 11/11/63.

<sup>79</sup>BT 1/30/61 (quote) and 6/5/61.

<sup>80</sup>BT 4/10/61 (quote), 10/16/61, 12/16/63 (quote), 1/13/64, and 2/17/64 (quote). The Federal Reserve also helped determine the flow of investment funds. “When the government holds down long-term rates, it drives more American investment abroad and discourages foreign investment here. If the Federal Reserve stopped inflating, and allowed domestic interest rates to be determined by market forces, there would automatically be less American investment abroad and more foreign investment here.” See BT 9/23/63.

<sup>81</sup>BT 9/9/63 and 10/25/65.



on various gold bills then pending before Congress.<sup>82</sup>

Hazlitt considered an international gold standard a bulwark against currency manipulation on the part of politicians and bureaucrats and a prophylactic against inflation. As such, he interpreted the Bretton Woods system as an outgrowth of the Keynesian animus against gold and its quasi-automatic stabilizing properties. Under a metallic standard, inflation compelled higher prices, shifted the balance of trade against the inflating nation, and precipitated an outward flow of gold. Shrinking gold stocks acted to contract supplies of money and credit, raise interest rates, arrest inflation, and bring the flow of trade back into equilibrium. According to Hazlitt, foreign bankers and currency dealers actually anticipated this sequence at the first hint of inflation, initiating an adjustment in the exchange rate and signaling central bank managers to raise discount rates to stem the drain on gold. "Unsound monetary and economic policies, or even serious proposals of unsound policies," Hazlitt suggested, "were immediately reflected in exchange rates and in gold movement." The inherent stability of fixed exchange ratios and free convertibility ultimately bolstered confidence and facilitated international trade and lending. The gold standard never "broke down" in times of crisis or war, Hazlitt insisted. Rather, it was willfully abandoned or undermined by the policies undertaken by public officials. The choice, then, between gold's equilibrating mechanism and a currency "managed" by bureaucrats was a choice between free enterprise and collectivist planning. Hazlitt harbored no illusions about the complications involved in restoring an international gold standard. In the end, however, he believed gold could prompt governments to act in ways that promoted liberty and prosperity: "to respect . . . private property, economize in spending, balance their budgets, keep their promises, and above all refuse to connive in . . . the overexpansion of money and credit."<sup>83</sup>

### MOVING ON

In 1961, publisher Philip Graham, president of the *Washington Post* Company, purchased *Newsweek* from the trustees of the Astor Foundation following Jacob Astor's death. His inspiration for the move came in the

form of persistent pleading from a group of *Newsweek* insiders, including managing editor Osborn "Oz" Elliot, Washington Bureau Chief Ken Crawford, and his assistant, Ben Bradlee. The change in ownership breathed new life into the magazine and signaled an ideological shift. Graham was friendly with Vice President Lyndon Johnson and enjoyed access to the Kennedy White House. Oz Elliot, elevated to the editor-in-chief position, likewise counted himself a Kennedy partisan who sought to challenge *Time's* market dominance by expanding the range of issues the magazine addressed and appealing to a younger audience. Even after Graham's suicide in 1963, Elliot continued to secure significant budget increases from his wife and successor, Katherine, to fund an overhaul in style and content. In addition to splashier graphics, he also inaugurated in-depth coverage of the major social and political trends of the sixties, including award-winning features on the civil rights movement that attracted prominent national attention and hundreds of thousands of new readers.<sup>84</sup>

Years later, Hazlitt attributed his departure from *Newsweek* in 1966 to the animus of Katherine Graham, but here his memory betrayed him. Graham generally deferred to Elliot on most editorial matters. Though the magazine's new management treated Hazlitt well, renewing his contract several times from 1961 on and providing him with a generous pension, plans were already underway to phase him out. Elliot concerned himself with balancing the personalities and politics of his regular columnists, bringing on Walter Lippmann and Emmet Hughes, for example, to balance Raymond Moley's "predictably conservative" views. In that vein, he "thought it equally desirable to counter the antediluvian economics of Henry Hazlitt with something closer to current day reality." In 1965, "Business Tides" began running on a biweekly schedule, alternating with a new column by Henry Wallich, Yale professor and former economist at the Federal Reserve Bank of New York. Wallich described himself as a "conservative," but noted in the same breath that "the new conservative in economics today must accept most of the

<sup>82</sup>"For Your Information," p. 1. The columns in question included *BT* 1/4/54, 1/11/54, 1/18/54, and 1/25/54. Other relevant selections include *BT* 11/21/49, 11/28/49, 4/30/51, 7/6/53, 3/1/54, 3/15/54, 7/2/56, 7/1/57, 7/29/57, 8/26/57, 12/22/58, 12/21/59, 1/31/60, 11/21/60, 1/16/61, 3/27/61, 5/22/61, 6/5/61, 6/19/61, 7/3/61, 9/18/61, 10/2/61, 10/22/62, and 2/1/65.

<sup>83</sup>On Keynes and gold, see *BT* 11/11/63.

<sup>84</sup>David Halberstam, *The Powers That Be* (New York: Alfred A Knopf, 1979), pp. 363–76; John Tebbel and Mary Ellen Zuckerman, *The Magazine in America, 1741–1990* (New York: Oxford University Press, 1991), p. 306; Michael T. Kaufman, "Osborn Elliot, Father of *Newsweek's* Rebirth, Dies at 83," *New York Times* (29 September 2008); "Osborne Elliot, 1924–2008: Remembering the Legendary Editor of *Newsweek*," accessed at [www.newsweek.com/2008/09/27/osborn-elliott-1924-2008.print.html](http://www.newsweek.com/2008/09/27/osborn-elliott-1924-2008.print.html); Katherine Graham, *Personal History* (New York: Alfred A Knopf, 1997), pp. 276–83, 344–49.

changes of the past 25 years and go on from there to improve them.”<sup>85</sup>

Elliot’s quest for diversity and new blood also led him to sign up two of the nation’s leading economists, Harvard Keynesian Paul Samuelson and Chicago monetarist Milton Friedman, completing the triumvirate that would replace Hazlitt. “We need three people to fill the spot formerly occupied by one,” Oz graciously informed him, although he was quite satisfied to usher the “dull right-winger” from *Newsweek*’s new, glossier pages. For his part, Friedman realized that his outlook and Hazlitt’s were “essentially the same,” so much so that he thought it proper to seek out his blessing before accepting the assignment—Hazlitt, of course, enthusiastically urged him to take it. Perhaps Elliot had imbibed enough of the Kennedy mystique to consider youth and Ivy League credentials sufficiently exciting. At any rate, Hazlitt was 72 years old in 1966, and ready to move on. Soon after his last column appeared on September 12, he received a fan letter testifying to his longevity and influence:

Some 35 years ago as a freshman or sophomore in an economics course at the University of Chicago I was assigned an article by you. I can’t remember its title, but I do remember its general subject matter: that the deductive method was indispensable in the field of science, including the social sciences. I was much struck by the example you gave of the discovery of the new planet (Neptune?) by Leverrier and Adams purely by deductions from Newton’s equations and the aberrations in the observed orbit of known planets. A writer never knows what his impacts have been. I can say that one of the reasons I decided to go into economics was reading your article.

<sup>85</sup>Osborn Elliot, *The World of Oz*, p. 66; Robin Gerber, *Katherine Graham: The Leadership Journey of an American Icon* (New York: Portfolio, 2005), pp. 114–15; “Alternating Experts,” *Newsweek*, 11 December 1964, p. 1, Folder “Newsweek Contractual Agreements,” Box B04, Subject Files, Henry Hazlitt Papers. See also Hazlitt to Gibson McCabe, 22 March 1961, McCabe to Hazlitt, 1 April 1961, Frederick Beebe to Hazlitt, 22 October 1964, Hazlitt to Beebe, 15 April 1965, Folder “Newsweek Contractual Agreements,” Box B04, Subject Files, Henry Hazlitt Papers.

The letter writer’s name? Paul Samuelson.<sup>86</sup>

## BACK TO THE FUTURE

The preceding pages have couched Henry Hazlitt’s significance predominantly in historical terms, but it is fitting to conclude by noting his continuing contemporary relevance. During his tenure at *Newsweek*, an era of growth and prosperity when federal budget deficits typically amounted to around 1 percent of GNP and citizens registered more confidence in the power of government to improve their lives, liberals could more easily dismiss Hazlitt as a crank. After surveying the economic landscape from the 1970s to the present day, however, he appears a lot less cranky, and a good deal more prophetic.

Even readers who do not necessarily share the depth of his profound libertarian suspicion of the state can appreciate the broader cautionary message Hazlitt delivered through the medium of economic analysis. The post-World War II mandate for government-managed prosperity, he warned, created an institutional bias toward inflationary policies that public officials, regardless of political orientation, would find difficult to resist or ultimately contain. In the long run, the hubris of technocrats offered no substitute for the decentralized genius of the market. Moreover, he observed, Liberalism could articulate no implicit limit on the scope of its socio-economic agenda, and so possessed no inherent brake on its recourse to state power. The private resources required to nourish the resulting public sector promised to be, in William Voegeli’s phrase, “never enough,” such that the welfare state threatened to sap the very social and economic capital that sustained it.<sup>87</sup>

<sup>86</sup> Hazlitt, “My Life and Conclusions,” pp. 57–58; Elliot, *The World of Oz*, p. 67; Osborn Elliot to Hazlitt, 14 July 1966, Folder “Newsweek Contractual Agreements,” Box B04, Subject Files, Henry Hazlitt Papers; Milton and Rose D. Friedman, *Two Lucky People* (Chicago: University of Chicago Press, 1998), p. 357; Paul Samuelson to Hazlitt, 15 September 1966, Folder “Paul Samuelson, 1966,” Box B05 Pi-Se, Correspondence Files, Henry Hazlitt Papers. The article Samuelson referenced was most likely “Economics: The Lively Science,” *The Nation* (6 May 1931).

<sup>87</sup>William Voegeli, *Never Enough: America’s Limitless Welfare State* (New York: Encounter Books, 2010). Many conservative economists, such as Chicago School monetarists, do not share the Misesian aversion to inflation that Hazlitt articulated. Accordingly, questions concerning the proper tolerance level for credit expansion in normal times or periods of economic distress continue to prompt lively discussions on the Right.

Hazlitt found no contradiction in a vision of progress achieved through free markets, individual initiative, and a smaller role for government. As he clarified in his final *Newsweek* column, his criticism of liberal economic and social policy did not arise out of callousness or disinterest in reducing poverty or increasing wages. “I do not differ from my ‘liberal’ correspondents in their goals, but simply in their proposed methods of achieving them,” he explained. “In trying to bring about some wished-for result directly and immediately, they too often fail to see that the ultimate results of the policies they propose will be exactly the opposite of what they desire.” Modern readers acquainted with economic stimulus plans, “quantitative easing,” automotive and bank bailouts, health care reform, “cash for clunkers,” housing and higher education bubbles, “green” jobs subsidies, underfunded state pension programs, public sector union contracts, climate change

legislation, the crisis of the Euro, escalating debt ceilings, denunciations of “tax cuts for the rich,” and “living constitutions” can certainly relate to such sentiments. The academic Walter Russell Mead suggested recently that if America is to prosper in the twenty-first century, “power is going to have to shift from bureaucrats to entrepreneurs, from the state to society, and from qualified experts and licensed professionals to the population at large.” The toolkit of twentieth century progressivism has little to offer in bringing about such a transition, but the “Business Tides” columns of Henry Hazlitt surely do.<sup>88</sup>

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<sup>88</sup>*BT* 9/12/66; Walter Russell Mead, “The Crisis of the American Intellectual,” accessed at <http://blogs.the-american-interest.com/wrm/2010/12/08/the-crisis-of-the-american-intellectual/>.

1946





## How 'Stabilization' Unstabilizes

September 30, 1946

After much wavering, the Truman Administration was finally brought, months ago, to acknowledge that price control could not work without wage control. But while its price ceilings have been fixed and rigid, its wage ceilings have from the first been vague, movable, and, in fact, fictitious. It has never applied the same principles to wage control as to price control and, to do it justice, it has never applied the same vocabulary. Prices have frankly been fixed; but wages have merely been "stabilized." Whatever nebulous meaning may once have attached to this word was completely lost in the settlements of the New York trucking and maritime strikes. It was at last made crystal clear that there is no national "wage policy" or "wage line" that cannot be destroyed the moment any powerful union chooses to challenge it through a strike.

The history of these "wage policies" has now become dreadfully repetitive. The various wage boards set up by the Administration, ostensibly for the purpose of "stabilizing" or holding down wages, have been in reality wage-boosting agencies. The famous 18½-cent wage-increase formula was an open invitation to every labor union leader to demand at least that. He could hardly afford to ask less for his members than the amount the President himself had declared to be only their just due. This "stabilization" policy could be put into effect as long as the government was forcing the oil, motor, steel, and other industries to pay greater increases than the unions could obtain through their own unaided bargaining power. The new 18½-cent higher ceiling was smashed the moment John L. Lewis decided to smash it. The government cooperated with him in smashing it, in fact, by seizing the mines and negotiating and signing the new ceiling-smashing contract with him itself. One consequence of this was the New York trucking strike and its settlement by wage boosts of 31 cents an hour.

The truth is that the government by its own policies has finally placed itself in a position where it must surrender to every strike. It not only fails to penalize; it rewards every strike by giving the strikers more than they would have got without striking. A never-ceasing round of strikes under these circumstances can hardly be regarded as a mystery. Every time the government buys off one present strike by forcing the employers to grant the substance of the demands made it buys itself twenty future strikes.

And it begins by creating a situation in which it is all but impossible for a union to lose a strike. By the

Wagner Act the government turned itself, in effect, into a union-organizing agency. One provision of that act makes it in practice impossible for an employer to dismiss men on strike and to hire permanent workers to take their place. Local governments, in addition, fail to provide adequate police protection not only for substitute workers but even for workers who wish to continue peaceably at their old jobs. Under these conditions all the natural risks are taken out of strikes, the previous function of the strikers cannot be taken over by anyone else, vital production must come to a halt, and the deadlock can only be broken by giving in to the strikers' demands.

The least that we may hope for is that the Administration will candidly recognize the situation it has brought about, and will now give up the pretense that it has any "wage stabilization policy" or that it can enforce any. But the logical and indeed the only workable corollary of abandonment of a wage control that has always been fictitious is an abandonment of price control; otherwise artificial scarcities must continue to be brought about and production must continue to be discouraged, unbalanced and disrupted. Yet the administrators hang on grimly to every inch of price control that the present extension law permits, and even interpret the law to retain far more control than Congress intended.

Though the national production of meat this year was substantially higher than in the prewar years, both the Price Decontrol Board and the Secretary of Agriculture calmly ruled it to be "in short supply." Restoration of price control then brought about the worst meat shortage in our history.

The government's "stabilization" policy, in short, continues to create worse difficulties than any it was designed to solve. ❀

## New Ironies of Price Control

October 7, 1946

It is hard to decide which has been more harmful—the new Price Control Extension Act or its administration. The law itself provided that controls could not be reimposed on meat unless meat was "in short supply." As the production of meat when the present law went into effect was substantially above the prewar average, meat could have been decontrolled immediately. But the Price Decontrol Board, instead of adopting the simple standard of supply mentioned in the law, put meat back under control on the ground that it was in short supply "in relation to demand at reasonable prices."

Under this elastic standard, price control can be retained indefinitely. A comparison of present with past supplies is definite and measurable, but a comparison of supply with “demand at reasonable prices” depends on the concept of reasonableness in the minds of administrators.

The new price-extension law was so badly conceived that only expert administration could have made it work. The administrators proceeded to follow the precise combination of policies likely to do the most harm. First, meat was needlessly put back under control. Then, as if to make certain that there would be a meat famine, grains and animal feeds were left free of controls, while the OPA delayed a couple of weeks in restoring ceilings.

Livestock raisers, fearing a profit squeeze, rushed their unfattened cattle to free markets while they lasted. This added temporarily to the supply of meat at the cost of a long-term shortage. When controls were restored, livestock raisers decided to fatten the cattle that remained on the range rather than sell it; at the latest, they figured, price control would end next June.

The result has been the worst meat famine in the nation's history. Residents of New York City found themselves for the first time reduced to trying horse flesh. Poultry and egg prices soared. Die-hard price controllers blamed this rise on the free market, though it should have been obvious that when a scarcity of meat was brought about by price control, the whole demand would concentrate on the substitutes remaining, and force their prices far above any levels that would have existed without price controls over other items.

The crisis reached a point where even the Democratic Majority Leader of the House, who had fought tenaciously to have price control restored, called for a 60-day suspension of controls over meat and other scarce foods. Republicans were prompt to denounce this as a political trick, and to point out that it would suspend price control over meat until safely after the elections and then probably reimpose it. But wholly apart from the political aspects, a mere 60-day “suspension” of meat controls would be another economic error. That was precisely what we had in July and August. A second price-control suspension would produce the same kind of results. When producers are left with a sword of Damocles hanging over them, they do not act as they would in a free market. The government cannot monkey with the price mechanism in this way without courting disaster. Only one thing will do now—the definite termination of meat control and, in fact, the definite termination of all price control.

What is particularly ironical is that the restoration of price control itself brought about the very shortage

in meat that the Decontrol Board and the Secretary of Agriculture declared to exist when there was no shortage. It would be embarrassing for Secretary Anderson to declare meat now not to be in short supply, in order to get rid of price controls, when he declared it to be short at a time when it was obviously more plentiful than today.

The dilemmas of the administrators are no worse than the paradoxes in the law itself. In the agricultural realm it provides for price controls only over commodities in short supply. But the effect of holding down the price of goods in short supply is to increase their consumption, discourage their production, and intensify the shortage. The only defensible course with regard to goods in short supply would be to ration them without controlling their price. This would restrict demand without reducing incentives.

Between price controls and priorities, production has been thrown into more chaos than we have ever seen in peace times. ❁

## Inflation, Deflation, Confusion

October 14, 1946

In the last two years left-wingers have been fond of referring to private enterprise as a “boom-bust” economy; OPA officials have contended that only price fixing can prevent a repetition of the 1920–21 boom and collapse, and British statesmen have insisted that their new “democratic socialism” will work beautifully if only mercurial America doesn't crack again and drag the rest of the world down with it. Small wonder that so many people now ask each other whether the recent slump in the stock market does not at last foreshadow this long-predicted business setback.

The question is not easy to answer, because the American economy has now become the football of political policies and counterpolicies that are not inherent in it but essentially external. These conflicting political policies are on the one hand those tending to create inflation, and on the other those tending to bring about disruption.

The inflationary forces are obvious, and until now have been controlling. Their primary causes are government deficit financing and other political policies that increase the volume of money and credit. Past inflationary forces are roughly measured by the increase in the national debt to \$265,000,000,000 and of money and credit to more than three times the prewar volume. Potential future inflation is indicated by a still unbalanced budget in prospect (in spite of a balance

in the first quarter of the current fiscal year), and by a policy of artificially low interest rates that promotes further increases in credit and further monetization of the public debt. As long as inflation raises prices faster than costs it stimulates business expansion, new ventures, and employment.

Against this, however, are equally powerful forces of disruption. The chief of them is price control, administered in a spirit hostile to profits and business. This has distorted relationships among profit margins and disrupted and unbalanced production. Builders find themselves with bricks and no doors, glass, or bathtubs. Automobiles wait on assembly lines for bumpers or batteries.

The profit squeeze from the top meets another from the bottom. Endless strikes, interrupting output, are followed by endless wage increases. To encourage or compel such wage increases the Administration ignores elementary property rights, seizes coal mines, and signs wage-boosting contracts itself. These wage increases must ultimately either raise costs to the point where many firms can no longer operate, or force up prices to levels that will cut off buying. In either case they will slow down production and force unemployment. Add to all this a basic hostility to business on the part of Washington agencies which is reflected in countless harassments.

Which of these two sets of forces will dominate the next six to twelve months—the inflationary or the depressive? That is impossible to say until we know the complexion of the next Congress and the main decisions that key political figures—President Truman, Secretaries Snyder, Byrnes, and Anderson, Paul Porter, Wilson Wyatt, Marriner Eccles, and members of the PDB, ICC, OWMR, NLRB and CPA—are going to make. The decisions of such men are incomparably more important today in determining the future course of business than the merely derivative decisions made by private businessmen.

One thing we could not have simultaneously is both “inflation” and “deflation,” for we could not have simultaneously both an expansion and contraction of the money supply. But we could have a frustrated inflation. We could have simultaneously, as experience in Europe has already proved, both inflation and industrial disruption, inflation and unemployment, inflation and stagnation.

The real danger we face in the next six to twelve months is that if the present combination of political policies brings about this result, Administration officials, instead of removing the throttling controls that cause it, may decide that the real trouble has been

insufficient inflation, and may embark upon the disastrous policy of further increasing and debasing the money and credit supply. Our greatest enemy today, in short, is the economic illiteracy and confusion on the part of those who insist on “planning,” “stabilizing,” and straitjacketing the economy and who have the political power to do it. ☸

## Price-Fixing Brings Bottlenecks

October 21, 1946

The meat shortage may serve as an illustration of the way in which price fixing brings about scarcity in general. As a result of ceilings, cattle raisers found it more profitable to fatten their cattle on the lots than to send them to market. This led to a whole series of other shortages. A soap crisis is being created because soap is mainly made from tallow and tallow comes from steers. Synthetic rubber and hence tire production are threatened in turn by the shortage of soap. A meat shortage also means a hide, leather, and shoe shortage. A bread shortage may come from a scarcity of lard needed in baking, for lard comes from hogs.

Production is held back everywhere by missing vital parts: automobile makers wait for sheet steel and radio makers for cabinets. The National Association of Home Builders, reviewing the veterans' housing program, has pointed out that “the success of the veterans' program will be measured not by the supply of the most available building material but by the supply of the least available building material.” It points, as one illustration, to the critical shortage of nails, “fast approaching a national scandal.” But as the remedy it proposes, not the termination of price fixing, but “incentive pricing” for nails.

Such a proposal indicates that even the chief victims of price fixing still fail to recognize that the problems which confront price fixers are inherently insoluble. If there is to be incentive pricing for nail manufacturers, why not incentive pricing for everyone? How can the government allow a higher rate of profit for nail makers as compared with brick makers, for example, without laying itself open to charges of favoritism?

How can it decide, in fact, just what rate of profit on nails as compared with bricks is necessary to bring forth just the right amount of nails as compared with the right amount of bricks? Or just the right amount of nails and bricks compared with the right amount of each of tens of thousands of other commodities? The output of every part must be synchronized with that of scores or hundreds of others if there are not to be bottlenecks which slow down whole industries.



The persistent belief among many businessmen that price fixing would be all right if it were “fairly administered”—if it allowed “cost of production plus a reasonable profit”—completely overlooks this problem. A uniform percentage profit for everyone (assuming that price fixing could achieve it) would give no more incentive for producing an article in critically short supply than one in relative excess.

The most brilliant of bureaucrats could not solve through price fixing the problem of balancing and synchronizing the production of thousands of different commodities in relation to each other. Yet this problem is solved quasi-automatically through the mechanism of free markets. When a given article is scarce in relation to demand its price immediately rises; the profit margin in making that article becomes greater than for making articles in ampler supply; manufacturers expand its output and new firms take up its production until the shortage is relieved and the price and profit margin once more fall to an equilibrium level with that in other lines. There is no delay and red tape in getting “price adjustment”; price changes occur daily and hourly the moment unfulfilled demands or increases in supply anywhere make themselves felt.

It is true that, in spite of all the complaints about specific shortages under price fixing, the figures of overall production, as compiled by the Federal Reserve Board, have been high. For July the Federal index of industrial production was 78 percent above the 1935–39 average. But before we attempt to explain this apparent paradox, serious questions must be raised concerning the accuracy of the Reserve index. Andrew Court of General Motors has pointed out that while the Reserve index showed automobile production 78 percent above the 1935–39 average in July, actual production that month was about 300,000 cars and trucks compared with an average of 335,000 for the 1935–39 period—i.e., down 10 percent instead of up 78 percent.

The Reserve index error is apparently the result of measuring production of cars and parts by the treacherous figure of man-hours worked instead of by the actual number of cars and trucks produced. ⚙

## Meat and the Speed of Decontrol

October 28, 1946

President Truman took exactly the right action on meat after giving all the wrong reasons for it. His arguments on the radio were necessarily inconsistent because he was attempting to do an inconsistent thing—to make the voters angry at the Republicans for trying to do in

July what he himself was at last being forced to do in October.

It was the President’s veto that brought about the summer price-control holiday he was deploring. This holiday was in fact salutary. For the first time in years it gave the American public a glimpse of the free market. In spite of the manipulation of index numbers by government agencies, the public knew that it was buying meat below the black-market prices that most buyers had previously been forced to pay. And the public was really getting meat.

Mr. Truman and his advisers now say, in fact, that it was then getting too much meat and that this is the real reason for the subsequent shortage. The figures do not support this contention. For a short six weeks meat production was up an average of only 30 percent above the corresponding period of the preceding year. But the stockmen who did rush unfattened and unfinished cattle to slaughter did so, not primarily because there was then a free market, but because they correctly feared an early reimposition of controls. The President himself conceded the truth of this when he wisely refused to declare another price-control holiday and announced instead that meat controls would be permanently lifted.

But Mr. Truman’s final wise act threw a sad light backwards on the price-control record of his Administration. He and his assistants had roundly denounced the Senate when it twice voted for termination of controls on meat. The Price Decontrol Board, had it acted with common sense and adhered strictly to the requirements of the law, would not have put meat back under control on Aug. 20. The Secretary of Agriculture had a chance to decontrol meat on Sept. 1 merely by failing to list it as “in short supply.” Production of meat was in fact then running above the prewar rate. He had a second opportunity on Oct. 1, but consistency with his September ruling forced him to pass it by.

When the Democratic Majority Leader of the House then called in alarm for a 60-day suspension of price controls on meat, the President flatly rejected the idea. Instead, Price Administrator Porter rushed to inform the country that “stabilization” was more important than steaks—in other words, that it was more important that the OPA should continue to fix ceiling prices on meat than that there should be any meat to buy. And then Mr. Truman acknowledged that, after all, it was price control that had been bringing about the shortage; and he lifted it.

A few weeks must elapse before meat on the hoof can become meat on the dinner table. Empty trade

“pipelines” must be filled up; meat in storage on Oct. 1 was the lowest in 30 years. As a result of this unprecedented shortage brought about by price control, meat prices temporarily soared, but began to decline in a few days and should be back in a few months to reasonable levels.

One of the most encouraging aspects of the President’s radio talk was his clear recognition that “the lifting of controls on meat . . . cannot be treated as an isolated transaction”; that we must “speed up the removal of price controls” and wage controls, and move “toward a free economy.” It remains to be seen how seriously these words will be taken and how quickly put into effect. At the moment of writing this our whole price-control system is a mass of fantastic contradictions. The price of whisky (except in new barrels) is controlled, but the price of milk is not. Lamb prices go where the market sends them; but automobiles are held down by government edict so that the poor can buy their share of Lincolns and Cadillacs.

How can this economic nightmare be brought to an end? The way to decontrol is to decontrol. The mere announcement of speedy decontrol makes it necessary, for it tempts middlemen to hold goods off the market until prices are free. Not only should decontrol proceed as rapidly as the present messy law allows, but the President should call Congress in special session immediately after election to repeal remaining price controls on everything except rent, and to turn rent control over to the states. ❀

## Squeezing the Price Balloon

November 4, 1946

The recent crisis in meat brought out an important consequence of price control that until now has been overlooked. It was illustrated most vividly by what happened to poultry and egg prices. When beef, lamb, and pork were put back under price controls in September, an immediate result was an increased price of poultry and eggs. The price controllers, naturally, blamed the free market. But the public had the good sense to realize that when price ceilings made meat impossible to get, and the whole demand for meat was concentrated on the only available substitutes, the prices of poultry and eggs were being forced substantially above what they would have been in a free market for everything. When ceilings were taken off meat, poultry and egg prices immediately dropped. And when ceilings were removed from margarine and other fats, the price of butter immediately dropped.

These effects on particular commodities merely illustrated a broad principle. The day after the President lifted meat ceilings, a regional price administrator declared that the OPA had never governed the entire economy. American consumers, he estimated, spent a total of \$250,000,000,000 a year; the OPA at its maximum had never controlled more than \$100,000,000,000 of this, and after the release of meat it controlled only about \$65,000,000,000 of goods.

These estimates are of doubtful accuracy, but they will do well enough to illustrate the principle. If the public buys altogether some \$250,000,000,000 of goods and services of all kinds (I suppose the OPA administrator included in this total real estate, securities, professional services, and other items never brought under ceilings) while the government controls the prices of only \$65,000,000,000 or even \$100,000,000,000 worth, what happens to the prices of the other \$150,000,000,000 worth?

To the extent that prices of controlled commodities are kept down by price-fixing, consumers will be able to get them for less. They will have just that many more dollars left over, therefore, to bid up the prices of the uncontrolled commodities. In other words, to squeeze down the prices of the controlled commodities is to force up the prices of the uncontrolled commodities.

What we have fundamentally is a certain total volume of money or money incomes bidding for a certain total volume of goods. If we increase that volume of money or money incomes without a corresponding increase in the volume of goods, the inevitable effect is to push up the prices of those goods. If we hold down the prices of part of those goods, we must either pile up a certain amount of unspent savings in the hands of the public, or we must divert part or all of that unspent amount to the uncontrolled goods. If you squeeze a toy balloon at one place, it will swell all the more at some other, because the gas pumped into it has to go somewhere. In the same way, if you prevent money from having its effect on goods at one place, it must affect goods all the more at some other. The money has to go somewhere.

This brings us to a major conclusion precisely the opposite of that usually drawn. The ultimate effect of fixing the prices of only part of the goods in an economy is not necessarily to reduce the general price level at all.

Perhaps the best solution of our immediate economic problem that is politically feasible is to decontrol everything but rents on old houses. But if we do this we must not retain rent control itself too long. For one consequence of holding down rents is merely to divert

that much more purchasing power to the bidding up of other commodities or services.

Because the problem that price fixing seeks to solve cannot be solved by partial price fixing, it does not follow that it can be solved by fixing the price of everything. Such a plan could be made to work in the long run only by universal allocation and universal rationing, not merely of raw materials but of labor. That could only lead to totalitarianism. The problem can be solved only by dealing, not with the mere symptoms and consequences, but with the basic cause of inflation. That basic cause is the increased issue of money and bank credit, and the policies that encourage it. ❁

## Leonard Ayres on Business Cycles

November 11, 1946

The death of Leonard P. Ayres last week at the age of 67 left a vacant chair in American economic life that will not be easily filled. His business forecasts were better known and more heeded than those of any other individual. With a firm theoretical grasp he combined an unexcelled knowledge of living facts. He ranks high among statisticians. His writing was distinguished for its clarity and compactness, and his charts for their telling simplicity. He arrived at his results by an elegant economy of means.

The last Cleveland Trust Bulletin to come from his pen, dated Oct. 15, was typical of his best writing. Two paragraphs from it not only illustrate his forthright analysis, but throw a sharp light on the current business situation:

"It is nearly incredible that this great essential [automobile] business, with its huge backlogs of unsatisfied demands, should be losing money in this postwar period. If the automobile industry and the construction industry were prosperous, this country would be experiencing a business boom that could be of exceptional duration. As things are, both of them are far from being prosperous. Their output is low and erratic; their prices are high; and their customers are dissatisfied. They are making progress toward greater efficiency of production, but it is disappointingly slow progress. Conditions in these two industries typify those in many other industries. The companies are suffering from shortages of materials, extreme wage increases, and low per capita production by employees.

"We have great productive capacity. We have more workers employed than ever before. There is ample credit available on easy terms for almost any

constructive enterprise that needs credit. We have great accumulated shortages of many kinds of goods, and large numbers of eager buyers competing for opportunities to buy the things they want. It is preposterous that under this combination of conditions the prospects for profits are so dubious that we have had a collapse of security prices. Wage costs per unit of production have advanced too rapidly, and price relationships are disorganized."

In 1939 Ayres published a volume on "Turning Points in Business Cycles." He found that over the previous 75 years a certain economic sequence had occurred "with almost complete regularity:" A rise in short-term interest rates had brought about a downturn in bond prices. This had been shortly followed by a downturn in stock prices. Declines in security prices had created unfavorable markets for new securities; the volume of new issues had consequently shrunk. With this decrease in the inflow of new funds into productive enterprise, a business decline had been started.

If we apply this description of the business cycle to current conditions, we find that part of this sequence has already occurred. Short-term interest rates began to stiffen perceptibly in March. In the first week of April high-grade bonds reached their peak level and then began to decline. The high point for stocks was not reached until May 29, and a violent fall has since taken place.

All this, however, does not in itself mean that a business decline is now necessarily in the offing; it may be doubted whether General Ayres himself, on this ground alone, would have predicted such a decline. For short-term interest rates today are highly artificial; their rise has been slight; they are still fantastically low; they still promote inflation. They can be held down to the present levels, in fact, only by a continued inflationary policy of keeping the money market flooded with funds. A moderate rise in short-term interest rates today need mean nothing more than the termination of dangerous artificial situations that should never have been permitted to occur.

A far more serious menace to continued prosperity has been a recent rise in wage rates without any corresponding rise in productivity. Leonard Ayres in his last Bulletin calculated that manufacturing costs per unit of production had risen by March of this year 64 percent above their 1939 level; 42 percent of this increase occurred in the preceding eleven months. Unless we can now achieve an increase in the volume of production without corresponding increases in hourly pay, this startling rise in costs may lead to a crisis. ❁



## The Consequences of Decontrol

November 18, 1946

In his sweeping decontrol order four nights after the election President Truman proved that he could recognize a mandate when he saw one. His decontrol order was not only, with the exception of one or two paragraphs, an eminent example of good sense; it was also, with this exception, an eminent example of good sportsmanship. Mr. Truman would have been more than human if he had not accompanied his decontrol order with at least a little attempt at face saving; but that little was unfortunate.

He declared that "the real basis of our difficulty is the unworkable price-control law which the Congress gave us to administer." It is true that the price-control law was unworkable; but this was precisely because of the provisions that Mr. Truman and his administrators had themselves insisted on, and not because of the amendments that Congress had inserted over their opposition. Some of its "fair-price" amendments never got a chance to go into effect; the so-called Decontrol Board did nothing but recontrol; and it is improbable that the President could have decontrolled first meat and then practically everything else without the discretionary decontrol powers which Congress insisted on giving his administrators without his or their request. Price control had lost popular support not, as the President asserted, because the law was "inadequate," but because it was altogether too adequate.

Nor is it true, as the President declared, that "in the fifteen months since V-J Day the stabilization program has preserved a large measure of general economic stability during a period in which explosive forces would otherwise have produced economic disaster." It is not true, either, that the situation today is "far more favorable for the return to a free economy" than it was only four months ago, when the President insisted on retention of overall price control for an additional full year.

On the contrary, it is altogether probable that prices will be higher this winter than they would have been if price controls had been lifted on V-J Day. For the effect of peacetime price control has been to retard, unbalance, and discourage production and to produce shortages. The net effect, also, of government intervention in labor relations and wages has been to raise wage rates faster than they would otherwise have been raised and to jack up production costs.

The first result of the President's decontrol order will be price advances in most of the products that have been controlled and sharp advances in the products that have been controlled most tightly. The most spectacular

advances will make the headlines, thus giving a distorted view of the overall picture. The advances will be blamed on decontrol. But the real reason, as in meat, will be the shortages brought about largely by control itself, supplemented by the wild swings inevitable when both buyers and sellers are first groping for the real equilibrium price.

While advances are still going on in some commodities, declines will be taking place in others, for the very reason that all commodities will be competing freely for the consumer's dollar, so that if more of it has to go for one commodity, less of it will be left for others. It may be doubted whether the general price level in the next few months will rise more than another 5 or 10 percent. And any general rise in the price level will be basically due, not to the absence of price controls, but to the increase in money and bank credit in recent years brought about by the war and by governmental policy. With the false remedy of price control out of the way, public attention will at last be able to concentrate on the real remedy for inflation, which is to halt the increase in the money supply.

In retaining ceilings on rents, the President doubtless followed the only course that seemed to him at the moment politically possible. But it is unfortunate that he did not at least remove rent ceilings at once on all new and remodeled housing; for such rent ceilings merely prevent a great deal of such housing from being built, and so themselves prolong the housing crisis. The next step should be to remove rent ceilings from all houses or apartments voluntarily vacated by the former tenants. The third step should be to allow at least some moderate maximum increase on new leases for old tenants. ❁

## Repeal Anti-Employer Legislation

November 26, 1946

If we are not to have a further great wave of strikes, if labor costs of production are not to be forced up to levels where it at last becomes impossible for industry to operate, there must be basic changes both in the text and administration of our labor laws. If the election of a Republican Congress was a mandate for anything, it was a mandate for this.

Central to any improvement in labor relations is revision of the Wagner Act. Any discussion which ignores the need for this must be set aside as unrealistic. The Wagner Act overshadows all labor relations and all wage negotiations, even where there is no direct appeal to it. It would not be difficult to suggest a dozen major



amendments to the act, all of which would improve it. But would they improve it enough to make it do what it ironically professes to do—"diminish the causes of labor disputes"? The real question is not so much what amendments should be added to the Wagner Act as what part of it, if any, it would be wise to retain.

Let us take in illustration Senator Ball's proposal to strip from the Wagner Act its legalization of the closed shop, and to write into the law, instead, a provision that membership in a labor union must not be a condition of employment. Such a change would remove an obvious self-contradiction in the act. Its supposed central principle makes it an unfair labor practice for an employer "by discrimination in regard to hire or tenure...or condition of employment to encourage or discourage membership in any labor organization."

If this principle is to be retained in law, then it should be retained in just this two-sided form. But this would make it logically compulsory to outlaw the closed shop, maintenance-of-membership clauses, the check-off, or any other device which makes employment contingent on union membership or compels the individual worker to join or stay in a union.

Could a two-sided law of this sort be enforced? If not, should the present purely one-sided act be retained? That act forces the employer (though not the union) to "bargain collectively." No one has yet succeeded in saying precisely what this means. It has been interpreted as meaning that the employer cannot break off negotiations even when he is slandered and abused by union representatives. It has even been interpreted as compelling the employer to make some kind of counteroffer, "to meet a union half-way," no matter how unreasonable its demands or what he can afford.

The employer is not allowed to "dominate or interfere with" any union or to "restrain or coerce" any employee in the exercise of union rights. These fair-seeming provisions have in practice been used to deprive employers of ordinary freedom of speech. J. Warren Madden, then chairman of the National Labor Relations Board, told a Senate committee in April 1939 that an employer who called a union leader a Communist might be held guilty of coercion under the Wagner Act even if his statement were completely true.

By the mere way in which it defines an "employee," the Wagner Act makes it illegal for an employer to discharge a striker and hire another permanent worker to take his place. Add to all this the failure of local governments to protect against violence and intimidation the workers who wish during a strike to continue peacefully at their jobs. Add the practice in some states of paying unemployment insurance to strikers. By government

policy, all the natural risks have been taken out of striking. It has been made all but impossible for a union to lose a strike. Should we be surprised that unions now keep raising their demands and threatening new strikes?

A commonly proposed remedy is to leave all present restraints on employers but to "balance" them by corresponding restraints on labor. It may be doubted whether such restraints would be enforceable. What we need at bottom is not "anti-labor legislation" but the repeal of anti-employer legislation. People are not born employers; they become employers by choice, and they can quit by choice if too much discouraged. Unless we restore to the employer the freedom to select his own employees, the freedom to hire and discharge solely on the basis of what is good for the business, we cannot maintain discipline, efficiency, or production—which means that we cannot maintain living standards. ❁

## How to Taper Off Rent Control

December 2, 1946

Now that ceilings have been removed on everything else, it is clear that rent controls ought to be whittled down. With the ceilings removed on wages and materials, on everything that goes into a house, it becomes administratively and economically absurd to maintain price ceilings on new houses. That is the best of all ways for assuring that they will not be built. For the same reason, it is obvious that rent ceilings of any kind should be removed on new housing. The only way to solve the housing problem, the only way to bring down rents in the long run, is to increase the supply of housing. The quickest way to increase the supply of housing is to provide the maximum incentives for its production. It is preposterous that the only major thing on which we should continue to squeeze down the profit margin is precisely the thing of which we are most eager to increase the supply.

It will be argued by many, however, that price and rent incentives are needed only to maximize the production of *new* housing, and that to take the ceilings off rents of *existing* houses would merely increase the living costs of tenants, and put windfall profits into the hands of landlords, without doing anything to increase the housing supply. But this argument has several flaws. It is not so easy to differentiate between "old" and "new" housing. Housing is not merely to be measured by square footage of floor space; it must also be measured qualitatively. Housing is continuously being repaired, improved, modernized; remodeled, extended,

transformed from single homes to small apartments, from residential to business use, and vice versa. Whether or not any of these changes are made in rented property depends upon the absolute or relative profit incentives involved. When rent control removes these incentives, property is simply allowed to deteriorate.

The country's available housing must at any time be rationed among its families. Under normal conditions it is rationed, like every other commodity, through the price or rent system through the competitive bids and offers of buyers and sellers, of tenants and landlords. Under rent control it is rationed by chance, luck, and favoritism. Those who happened to be in the housing they wanted to be in at the end of the war found themselves comfortably frozen in by OPA regulations. Veterans, war workers, and others who had given up their housing during the war found themselves frozen out by the OPA regulations and unable to compete on an equal bidding basis against existing floor-space holders.

In August, according to the Department of Commerce, the nation's income payments were 152.3 percent greater than in 1935 to 1939. In the same month, however, according to the Bureau of Labor Statistics, average rents had gone up only 8.7 percent. This means that the overwhelming majority of people have been called upon to pay a much smaller percentage of their income for rent than before the war. The result has been that residential floor space has been used more wastefully. An average of 3.1 persons, according to a census report, occupied the same number of rooms in 1945 as 3.3 had occupied in 1940. This is the real secret of the housing "shortage." It is caused primarily by rent control itself. Yet this shortage has become in turn the basis for insisting that rent control must be continued.

One final argument is that the removal of rent control would cause inflation, and raise the cost of living. Inflation, however, is caused by the overissuance of money and bank credit. It is true that the removal of rent ceilings would be followed by an increase in rents, but this would not necessarily lead, in the long run, to an increase in living costs. For with more of consumers' incomes being paid for rent, just that much less would be left to bid up the prices of everything else. It is precisely because rents have been kept down so drastically that, with existing money incomes, other prices have been bid up as high as they have.

Popular adherence to artificially low rents is still so powerful that it would be doubtless politically unrealistic to recommend immediately the entire elimination of rent controls. A possible compromise might involve (1) an immediate removal of all price and rent controls

on new houses; (2) a maximum permissible increase in rents for existing tenants of 15 percent in the next calendar year, with complete decontrol thereafter. ❁

## What's Wrong with Our Labor Policy

December 9, 1946

The coal strike has vividly revealed what is wrong with our present labor laws and previous labor policies. This, unfortunately, is no assurance that right policies will now be applied. A crisis may force men to revise their ideas; but no crisis, however great, can force them to think clearly. So the coal strike has revived all the old schemes for compulsory arbitration and for making strikes on public utilities illegal.

But if the coal strike has proved anything at all it is that these schemes simply do not work. The Smith-Connally Act, under which the government has been trying to combat John L. Lewis, is precisely such a scheme. It makes "wartime" strikes against the government illegal. But the first serious attempt to enforce this provision of it has proved futile. The government is afraid of making a martyr of Lewis. And it has no assurance that jailing him will stop the strike.

Compulsory arbitration of labor disputes, in fact if not in name, was tried during the war. It worked only when it gave the unions substantially what they wanted. When it did not, Lewis and other union leaders simply ignored or defied the War Labor Board, and the government was too frightened to do anything about it. The Railway Labor Act, in fact if not in name, imposes compulsory arbitration, certainly so far as the employer is concerned; but whenever one of the railway emergency boards has handed down a decision that the unions did not like they have defied it, and the government has been obliged to change its decision.

The assumption behind all the proposals for government "fact-finding" or compulsory arbitration of labor disputes is that the government board or "court" will know what is the "fair" or "right" wage and will settle the strike on that basis. This overlooks all the realities. The truth is that when a governmental board decides such questions it almost invariably, and sometimes grossly, favors the union—not merely because this seems the best political course, but because this is the way to make the decision stick. For the board is usually trying to avert a threatened strike or settle an existing one. It is therefore much more concerned to satisfy the union than the employer. And the very fact that government intervention of this sort exists or can be appealed to destroys any real collective bargaining.

Neither side will make a settlement if it thinks that a government board will award it something better.

Finally, even if the government board or “court” were courageously impartial, and much better informed on economic affairs than politically appointed boards are in the habit of being, it would be no more capable of fixing a “right” wage for each class of worker and occupation than of fixing a right price for each article. Compulsory arbitration of labor disputes means, in effect, government wage fixing. Government wage fixing would soon politically necessitate a return to government price fixing. Such a scheme, in short, would drive us back toward a controlled if not a totalitarian economy.

Only when such remedies are recognized as false are we likely to adopt the real remedy. This is simply to repeal the discriminatory curbs on employers and the discriminatory immunities to unions that we have enacted in the last fifteen years, and to subject both employers and unions impartially to the common-law provisions against force, fraud, intimidation, and violence. We may add whatever machinery of mediation or voluntary arbitration we think likely to be helpful; but the solution lies in restoring common rights and duties.

It is true that this will not prevent all strikes; nor will any remedy under a free system. But it would mean a tremendous improvement over the present legal situation, which, by making it all but impossible for a union to lose a strike, has put enormous irresponsible power into the hands of labor leaders. The Lewis coal strikes of 1927 and 1932, before we had a Wagner Act, collapsed completely. His union was shattered and prostrate until it was put on its feet first by the NRA, and then by the Wagner Act. What the Federal government needs to do today is not to prosecute Lewis in the courts, but simply to stop building him up. He seems very tall because he is standing on the Wagner stilts. Kick these out from under him, and he will shrink to normal size. ❁

## Inviolate Rights—For One Side

December 16, 1946

Federal Judge Walter J. La Buy has decided that the Lea Act, or “anti-Petrillo law,” is unconstitutional. The Lea Act makes it unlawful to use “force, violence, intimidation, or duress” to “coerce, compel, or constrain” a broadcasting company to employ any “person or persons in excess of the number of employees needed...to perform actual services.” Judge La Buy proceeds to argue that “the number of employees needed” cannot be objectively established, and that the law would therefore make the

guilt or innocence of the union wholly dependent upon the judgment or “whim” of the employer.

Such a conclusion ignores the fact that it is not the number of employees that matters, or even the objective necessity for their services. It is the use of “force, violence, and intimidation” to impose upon employers more workers than they want. Has it become “unconstitutional” to forbid unions to use force, violence, and intimidation” for this purpose—or any other?

Candor must concede that the Lea Act is inherently foolish. Judge La Buy correctly argues that under the Lea Act “broadcasting station employees are singled out and held to a more rigid rule than any other employees.” The Lea Act implies that it is all right for telephone unions, or railway unions, or barber shop unions, to force employers to hire more men than they need. It implies, in fact, that it is all right for a union to force any employer whatever to do anything else it can think of.

At least one ground on which Judge La Buy holds the Lea Act to be unconstitutional that it makes acts unlawful “when applied to these [broadcasting] employees and no others”—could have been avoided if the Lea Act had simply made it unlawful for unions to try to secure any end at all by “force, violence, intimidation, or duress.” But such a law, stating a rule that the common law has always been supposed to apply to everyone anyway, ought not to be needed at all.

Judge La Buy’s decision is a fresh reminder of how one-sided the application of so-called constitutional guarantees has become. One ground on which he sets aside the Lea Act is this: “A statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application violates the first essential of due process of law.” Yet under the Wagner Act it is an unfair labor practice for an employer “to refuse to bargain collectively.” And nobody has yet succeeded in defining precisely what this means.

In 1940, a House committee sought to reduce the vagueness of this requirement by proposing that it should not be construed as “compelling or coercing either party to reach an agreement or to submit counterproposals.” The American Federation of Labor succeeded in having this proposed definition withdrawn.

Judge La Buy, again, argues that “peaceful picketing” is “a form of speech and discussion that cannot under the First or Fourteenth Amendments be curtailed by any legislative enactment.” Let an employer denounce a union, however, in the unbridled terms in which the union denounces him, or let him advise his employees not to join that union, and he will soon find that his own freedom of speech is not beyond dispute.



“Under the Thirteenth Amendment,” continues Judge La Buy, defending strikes, “the right of any worker to leave his employment at will, or for no reason at all, is protected and that right is inviolate.” But let an employer try to discontinue employing somebody at will, or for no reason at all, and he will soon find that his right to do this is anything but inviolate.

It is not because the coal unions enjoy the unrestricted right to strike that John L. Lewis did and can at any time bring the nation’s coal industry to a halt. It is because the coal operators, under the Wagner Act, have lost the right to negotiate with anyone else but Mr. Lewis. It is because they have lost the right to drop strikers and hire other permanent workers to take their place. The Lewis union, because of ill-advised strikes beginning in 1927, had fallen almost completely apart in 1932. It was Section 7a of the NRA in 1933, supplanted by the Wagner Act in 1935, that put the union together again, and at last put it in undisputed control of the entire coal industry. ❁

## Twenty Labor-Act Revisions

December 20, 1946

John L. Lewis’s cancellation of the coal strike was not a surrender but a strategic postponement. In ordering the miners back to work “until 12 o’clock midnight, March 31, 1947,” he was in effect issuing a new strike call for that time.

There is no longer any excuse for regarding Mr. Lewis as an isolated accident. His solid support by both AFL and CIO leaders makes him a fitting symbol of the real labor problem today. That problem is not “Labor versus Capital” but the irresponsible and unbridled power of labor-union bosses.

The only proper way in which Lewis and other union bosses can be curbed is by a thorough revision of existing labor law, particularly the Wagner Act. Short of repeal, here are the amendments necessary:

1—Remove the joker which deprives management of the power to dismiss strikers and offer permanent employment to other workers. This more than any single provision has encouraged strikes by making it impossible for employers to take the normal means to counteract them.

2—Halt the NLRB’s drive to unionize foremen and other representatives of management.

3—Forbid unionists as well as employers to “interfere with, restrain, or coerce” workers in the exercise of their right to join or not to join unions.

4—Restore employers’ freedom of speech about unions wherever it does not involve actual threats.

5—As long as the law forbids employer “discrimination...to encourage or discourage membership in any labor organization,” it must in consistency also forbid the closed shop, “maintenance of membership,” and the checkoff.

6—Define “collective bargaining” so that it cannot be construed to require either party to meet a demand of the other in whole or in part.

7—Require unions as well as employers to bargain under this clarified definition.

8—Permit a majority union to bargain for its own members, but not “exclusively” for all workers unless the employer consents.

9—Remove the NLRB power to name any bargaining unit larger than the workers for a single firm. This would not illegalize nationwide unions, but simply withdraw Wagner Act support from them.

10—Restrict the NLRB’s power to throw off the ballot whatever it chooses to call a “company union.” Allow employees “representatives of their own choosing.”

11—Permit employers as well as unions to ask for bargaining elections.

12—Provide that any union claiming NLRB protection must come with clean hands; must use legal methods; must not be run by racketeers; must elect officers at reasonable intervals, publish accounts, have reasonable initiation fees and dues, and must not exclude new members unless they cannot meet fair skill standards.

13—Confine Federal intervention to workers clearly in interstate commerce.

14—Delete the clause that in NLRB proceedings “the rules of evidence prevailing in courts of law shall not be controlling.”

15—Put the burden of proof on the complainant.

16—Allow appeals from NLRB decisions to the courts.

17—Make factual findings of the NLRB no longer “conclusive” unless they are clearly sustained by the evidence.

18—Punish unfair labor practices by reasonable indemnification of the aggrieved employee but not by his compulsory reinstatement.

19—Repeal or revise the Norris-LaGuardia Act to make unions once more responsible for acts of their agents and to permit courts to halt union intimidation or violence.

20—Allow antitrust acts to apply against clearly antisocial practices of union monopolies.

Will all this mean excessive union regulation, a violation of labor’s basic rights? If so, union leaders are

free to choose between two-sided law of this kind and terminating the present one-sided coercions against employers. It should be pointed out, however, that a revised labor law of this kind would do nothing to illegalize strikes. It would even continue to leave some unions free to act antisocially. But it would at least no longer fasten such unions on employers by law. ❁

## The New CIO Wage Drive

December 30, 1946

Preparing to soften up industry for its new wage drive, the CIO leadership has laid down a greater barrage than ever of statistics, theories, and fulminations. What stands out in the "study" made by Robert R. Nathan for the CIO is the double standard used in making wage and price comparisons.

Average hourly earnings of manufacturing labor in October of this year reached \$1.13. This is the highest hourly wage for any month in American or world history. Average weekly earnings in October, at \$45.83, though higher than those for any month since V-J Day, were, however, \$1.50 less than those of January 1945. The Nathan report makes all its weekly wage comparisons with this January 1945 figure. It does not trouble to remind the reader that this was the absolute wartime weekly wage peak. Nor does it remind him that manufacturing labor worked an average of five hours more a week in January of 1945 than it did this October. Is it consistent to ask for higher pay for a longer week while rejecting lower pay for a shorter week? Mr. Nathan himself admits that hourly labor costs, even with considerably less overtime, were 8.6 cents higher in October this year than in January 1945.

When Mr. Nathan is discussing corporation profits, however, 1945 is promptly abandoned as the basis for comparison. That basis then becomes 1936 to 1939. In taking these four years as a norm, Mr. Nathan neglects to point out that nearly half of all corporations had no profits whatever to report then, and that there was an average of 8,000,000 unemployed throughout the period. Is that the sort of era the CIO now wishes to restore?

Incidentally, if that period were also taken for measuring wages, Mr. Nathan would have to point out that weekly money wages have since doubled. After full allowance for the increased cost of living, "real"

weekly wages are still 33 percent higher than 1936 to 1939 levels.

If Mr. Nathan had written down corporation earnings, as he does wages, to their comparative purchasing power, he would have had to make drastic reductions in his calculated percentages of increase. But he does not even compare money corporation earnings in 1936 to 1939 with actual corporation earnings today. He compares them with his own very high forecast of what these earnings are going to be. His guess may possibly be right; but he has hitherto not done well as a prophet. It was he who was responsible for the official OWMR forecast in October of 1945 that unemployment would rise to 8,000,000 in the spring of this year.

Suppose, however, that the profit forecasts of Mr. Nathan and the CIO leaders prove to be correct. How do they decide what profits are "enough" and what are "too much"? The unprecedented wages of American workers have been made possible by our national accumulation of capital and our willingness to risk it in enterprises that give jobs. Capital always runs the risk not only of losing its return, but of being lost itself.

Does the CIO know exactly how great a return is necessary not only to permit capital savings, but to induce investors to risk them in creating jobs? Profits as a percentage of the national income are today even—if we accept Mr. Nathan's high guesses—actually below the level normally attained in prewar years of reasonably good employment. Corporate profits are normally about 9 or 10 percent of the national income. Would that be too high a price to pay for full employment and the highest general living standard in the world?

Mr. Nathan and the CIO leadership look at wage rates only from one side—as the basis of labor's purchasing power. They refuse to look at them from the other side—as management's costs of production. They know that goods priced too high must mean a reduction in sales. They try to ignore or deny what is equally true—that labor priced too high must mean a reduction in employment. When wage rates force up production costs to a point where business cannot operate, or force up prices to a point where consumers can not or will not buy goods, neither purchasing power nor production is increased. Both, on the contrary, are destroyed.

That a new wave of wage increases will force this result is the real danger the country faces today. It is precisely the opposite of the danger that Mr. Nathan and the CIO leadership now profess to fear. ❁

1947





## The 'Purchasing Power' Theory

January 6, 1947

The CIO argument for another general wage increase of 25 percent has caused such deep concern not merely because the statistics on which it is based are so misleading but because the policy the labor organization advocates is a threat to the survival of the free-enterprise system itself.

In the period 1929 to 1945, wages and salaries averaged 69.6 percent of the national income. Corporate profits averaged 4.9 percent. After allowing for wages from non-corporation sources, a 25 percent increase in wages, without any increase in prices, would wipe out corporate profits several times over.

The CIO will no doubt answer that this does not apply today because corporate profits are now so "fantastically high." As George Terborgh has shown, however, corporate profits, even on the high guess of Robert Nathan, are today actually lower in relation to the national income than in any other full-employment, peacetime year on record.

Here is a fact that will repay contemplation. The last sixteen-year period, two-thirds of which was a period of mass unemployment, and the rest of abnormal profit taxation, has led us to forget what level of corporate profits, in relation to the national income, has been normal with full employment. The thesis of the CIO seems to be that high profits mean depression and low profits prosperity. The statistics show the precise opposite. Full employment goes with high profits, and mass unemployment with low profits or deficits.

From 1929 to 1945 the years of highest profits were the years of highest employment, the years of lowest profits the years of lowest employment. When corporations as a whole took a loss, in 1931, 1932, and 1933, we suffered the greatest mass unemployment in our history. The year in which labor got the greatest percentage of the national income it has ever had was 1932. From 1909 to 1929, the lowest profits came in 1921, the year of greatest depression and unemployment. A dozen of the 21 years from 1909 to 1929 were years of substantially full employment. In those dozen years the average ratio of corporate profits to national income was not 5 percent, but 9.75 percent.

The statistical case for the CIO purchasing-power theory, in brief, is simply nonexistent. The chief of the many fallacies on which the CIO purchasing-power theory rests is that of mistaking consequences for causes. It is true that when production is highest, real income is highest and real purchasing power is highest (though these must not be confused with income

or purchasing power stated as monetary totals without allowing for price levels). But that is because production, real income, and real purchasing power are, in effect, three names for the same thing.

It does not follow that we can invoke or perpetuate prosperity merely by raising wage rates above their existing level, whatever it may happen to be. Even if this step had the first results that the purchasing-power theorists suppose, it would obviously deduct as much from the purchasing power of investors, employers, and all other groups in the nation who normally contribute about 30 percent of its purchasing power, as it would add to the purchasing power of labor.

But such a step does not have even the first results that the purchasing power theorists imagine. If the wage increase is confined to the strong unions, it forces an increase in the prices of what these unions make. That means a rise in the living costs, and a corresponding decline in the real purchasing power, of all other workers. If the wage increase is general, it must force a general increase in prices that cuts back the real purchasing power of everyone, including the workers who have received the increase. This rise in prices discourages buying, and therefore produces a contraction in production and employment. If, finally, an attempt were made to take the wage increase entirely out of profits, as the present CIO program contemplates, marginal producers would be thrown immediately out of business. Mass unemployment would once more be upon us.

That is why the present CIO plan is the most dangerous anti-labor program that has ever been proposed. What we need are the particular wage rates and prices that will encourage the highest possible employment, payrolls, production, and sales. These equilibrium wage rates and prices can be found only by free markets. ❀

## The High Cost of Judicial Legislation

January 13, 1947

The decision of the Supreme Court in the Mount Clemens Pottery case on June 10 has brought on union claims for alleged unpaid wages that could completely ruin great American industries. We can find the simplest way to extricate ourselves from this "portal-to-portal" mess by retracing the legislative and judicial blunders that got us into it.

The Fair Labor Standards Act of 1938 prescribes a minimum hourly wage of 40 cents. But it goes on to provide that an employer must pay "not less than one and one-half times the regular rate" for all hours above 40 a week. It is the latter provision that extends

the control of the Federal government over the wages, high or low, of practically everybody. It benefits most the highest paid and penalizes most the employer who pays most. If he pays his workers only 40 cents an hour, he is penalized only 20 cents more for overtime, but if he pays them \$1.50 an hour, he is penalized 75 cents more for overtime.

But Congress at least stopped with this blunder. It did not go on to redefine what constitutes an hour's work. This meant that it accepted the established customs of industry in this respect. This was the sensible view taken by the special master appointed in the Mount Clemens Pottery case, by the Circuit Court of Appeals in overruling the district court, and by the Supreme Court minority.

But it was not the view of the Supreme Court majority. Mr. Justice Murphy argued that walking time to the place of work within the employer's premises must be considered part of the working hours, because "without such walking on the part of the employees, the productive aims of the employer could not have been achieved." On this logic, there is no reason why he could not have gone on to include in working hours the time spent by the worker in traveling to work from his home, or even the time spent in getting up, dressing, or reasonable sleep-for without such activities on the part of the employees, the productive aims of the employer could not have been achieved either.

Justice Murphy even boldly declared that "the statutory work-week includes all time during which an employee is necessarily required to be on the employer's premises." Yet there is no such definition whatever of the workweek in the statute. It is arbitrarily imposed by the Supreme Court.

This is a glaring case of judicial legislation. If the Supreme Court is to be free to rewrite legislation in this way, under the guise of telling Congress what it really meant to do, then it becomes a third house of Congress whose members cannot be reached by the voters and whose laws cannot be vetoed. This is intolerable. There is a simple way in which Congress can rebuke such judicial usurpation as it must be rebuked, and at the same time prevent the immeasurable harm that the Mount Clemens Pottery decision could work. It should pass a joint resolution reading somewhat as follows:

"In using the word 'work-week' in the Fair Labor Standards Act Congress did not mean to redefine this common term or to set aside long-established contracts or customs which had absorbed in the rate of pay of the respective jobs recognition of whatever preliminary activities might be required of the workers for that particular job. 'Work-week' is a simple term used by

Congress in accordance with the common understanding of it. For the courts to include in it items that have been customarily and generally absorbed in the rate of pay but excluded from measured working time is not justified in the absence of affirmative legislative action."

These are not my words. They are taken straight out of the dissenting opinion of the Supreme Court minority in the Mount Clemens Pottery case. This joint resolution could be supplemented, under ample precedents, by an amendment to the Fair Labor Standards Act closing the Federal Courts to all suits of the type now being filed by unions. Congress need not stand by helpless when a court presumes to tell it that its own law means what it does not mean.

If it wants to go farther, and undo some of the harm it has itself done, Congress should reduce the legal minimum overtime wage rate to 50 percent above the *legal minimum* regular rate. This would confine its intervention to the wages of marginal workers. It should stop trying to regulate everybody's. ❁

## How to Reduce the Budget

January 20, 1947

The most important thing about the budget for 1948 is its overall dimensions. It calls for expenditures, in the second full year of peace, of \$37,500,000,000. This is more than was spent in four whole years just before the war or in twelve whole years around the '20s. It permits no reduction whatever in the present wartime level of tax rates. And it provides a balanced budget only on the most optimistic assumptions.

A regular technique has now been established for disposing of those who express concern about a peacetime budget of these dimensions. It is to ask tauntingly: "Where would you cut?"—as if no answer could be given except something like "I'd refuse to pay the interest on the national debt," or "I'd cut out national defense." Sensible budget economies, of course, can never be made by offhand amateur efforts to throw out arbitrarily whole categories of expenditures. But it is absurd to conclude that substantial budget economies therefore cannot be made at all.

What is mainly wrong with the rhetorical "Where would you cut?" is its implicit assumption that the burden of proof is on those who wish to cut. The burden of proof, on the contrary, must be on those who wish to make the expenditures. Any dollar of expenditure that they cannot affirmatively justify ought not to be made. It is the duty of Congress, acting on behalf of the American people who are asked to pay the bill, to

scrutinize every dollar of these proposed expenditures with the utmost care.

The duty of scrutinizing requests for funds falls upon the Congressional appropriations committees. They need to do a far less perfunctory job than they have done in the last sixteen years. They need expert investigators. They need examiners who know what questions to ask and what evidence to require. Such a procedure would squeeze down present estimates, with few exceptions, all along the line.

The biggest items, of course, would profitably repay the closest scrutiny. Perhaps we do need to spend more than \$11,000,000,000 for national defense in 1948. But the question is not closed by mere rhetorical insistence that "We cannot imperil our national defense." This sum for one peacetime year is more than we spent on defense in the whole fourteen years from 1926 through 1939, in the latter half of which the Nazi and Japanese aggressions were yearly mounting.

It may be replied that we were starving our armed forces at that time. Yet it is still appropriate for Congress to ask first, whether we now need to spend more than \$11,000,000,000 a year on defense, and second whether, if so, the armed forces are proposing to spend all the money in so effective a way that we shall actually be getting \$11,000,000,000 worth of defense.

The same type of scrutiny might be made regarding expenditures for veterans' benefits. For 1948 these are set down at \$7,343,000,000. This is the estimate of the President a year ago for veterans' benefits even in the current fiscal year. It exceeds our entire Federal expenditures for all purposes whatsoever in the fiscal year 1938. It will bear examination. If the President's estimates for national defense and veterans' benefits, as well as other major items in our national expenditure, are to be considered sacred and untouchable, we shall never get economy.

A final fact must be borne in mind when the budget is discussed. There are few Federal expenditures for which some plausible defense cannot be found. People tell us that we "must" keep this or that item in the budget because it does this or that good. What is forgotten is that every dollar of budget expenditure means the removal of a dollar from somewhere else by taxes. It is money that the taxpayers could and would otherwise use to buy things that they need themselves. Where the taxpayers are corporations, it is money that would probably be used for expanding plant, increasing production, providing employment and higher wages out of increased productivity.

The unparalleled burden of taxation on this country today discourages and retards increased production and

industry growth at a thousand points. It is hurting our strength for either war or peace. This above all is what should be constantly kept in mind. ❁

## 'Stabilizing' the Economy

January 27, 1947

President Truman's recent economic report to Congress was a self-contradictory document, in which conflicting economic philosophies nestled cozily side by side. The report was full of expressions of faith in a free economy. Yet one recommendation after another was based on the assumption that the economy would not in fact be stable without government intervention and control at a score of crucial points. The phrase "consumer purchasing power" kept beating through the message like a tom-tom. The net result was a victory for the old New Dealers over the new Council of Economic Advisers.

For if there is any consistent basic assumption in the report, it is that the maintenance of "consumer purchasing power" is the one thing that matters. If this term means merely monetary purchasing power, it is naked inflationary doctrine. If it refers to real purchasing power (after price rises are allowed for) it confuses consequence with cause. It looks at everything purely from the consumer's side. The problems of production below receipts from sales are ignored.

The president recommended that Congress should extend rent control beyond next June. The only reason he gave is that "a large increase in rents would substantially reduce consumer purchasing power." But an increase in rents would not reduce national purchasing power at all. Landlords would have just as many additional dollars as tenants had fewer. The real difference would be that a larger percentage of the nation's monetary purchasing power would go for rents, leaving a smaller percentage over for everything else.

The prices of other things (if there were no further monetary inflation) would fall to compensate for the rise in rents. The cost of living therefore would not on net balance increase.

Such a readjustment, it is true, would create strains in the economy. In many lines costs have already gone up to a point where producers could not absorb a price decline. This does not mean that it would be a mistake to remove rent control in June. It means, on the contrary, that it would be mistake not to make at least a beginning now in allowing rents to rise. For these economic strains will have been caused by the very fact that rent control in the first place was so much more stringent than any other form of price control.



To prevent a serious problem of readjustment to resume when rents are allowed once more to resume their normal relationships to the general price level, we should allow any future monetary inflation (if, as is probable, we fail to prevent such inflation) to be absorbed through a rise in rents instead of a still further rise in other prices. If we wish to continue rent control after June we must at least remove rent control from all houses not yet built, and allow at least a 10 or 15 percent increase in rents of existing apartments for the coming year.

The President wants social security benefits revised upward. These payments, he thinks, will “provide a desirable support to mass purchasing power.” If these additional social-security payments are financed by a budget deficit, they will simply produce the inflationary consequences that the President elsewhere in his report deplors. If the payments are financed out of taxes, as much purchasing power will be taken away by greater taxes as is added by the payments. There will be no net increase in “mass purchasing power.” On the contrary, bigger and longer unemployment insurance payments, as experience has shown, only buy more unemployment. This reduces production and real purchasing power.

The most topsy-turvy conclusion in the report is that: “In the present economic situation, it is clear that it would be unsound fiscal policy to reduce taxes.” The real conclusion, of course, is that it is entirely unsound fiscal policy to maintain such a fantastically high level of government expenditures. If expenditures were slashed sufficiently, then a substantial cut in taxes would still leave the desired surplus. The present level of taxation is a constant threat to production. It is a threat to the very maintenance of a healthy free enterprise system. Not unless the executive departments justify every dollar of the proposed huge \$37,500,000,000 expenditure for 1948 can the President’s conclusion about existing taxes be accepted. ❁

## The Fruits of Foreign Lending

February 3, 1947

Now that the International Monetary Fund is no longer a dream but a reality, all the problems that were so lightly set aside by the rhetoric and propaganda used to get the plan adopted by Congress are beginning to emerge in their full dimensions. The whole approach at the Bretton Woods monetary conference was unsound. The International Bank, and particularly the fund, were set up to deal merely with the symptoms

and consequences of international monetary chaos and not with its causes. The irony of the fund is that it could work only under practically ideal conditions, in which it would not be needed.

The first thing to remember is that monetary chaos is not primarily “international” at all. It exists basically within each nation. If each nation’s currency unit were freely convertible into a definite weight of gold, if there were no overissue of its currency, so that this convertibility could be at all times maintained, then the relationship of one currency to another would necessarily be fixed and stable. If the dollar were always convertible into, say, one-thirty-sixth of an ounce of gold, and the pound into one-ninth of an ounce of gold, then pounds would always be freely convertible into dollars at a ratio of one to four. But where there is no common unit of measurement there cannot be anything more than, at best, a temporary and unreliable exchange stability.

The Bretton Woods arrangements ignored all these basic considerations. They tried to cure international monetary instability by hiding its symptoms or preventing its consequences. They provided in the fund that when any nation’s currency started to slide downward, the nations with relatively strong currencies must use them to buy the weak currencies at par. Of course a currency can be kept at par by doing this—as long as the strong nations are willing to throw their money away and as long as that money holds out.

United States Steel or any other stock could be kept at par as long as someone with sufficient funds kept in a standing bid to take all the stock offered at par. But the SEC and the stock exchange would soon bring charges against such a bidder of flagrant manipulation. If a private agent, moreover, used his client’s money to buy stocks or anything else above the open-market price, he would be sued for breach of trust or dissipation of funds. But when governments do such things, they are given pleasanter names and are justified by the complex reasoning of “economic experts.”

The managers of the fund are not even permitted to make their buying of currencies contingent upon internal reforms in the nations whose currencies they are supporting. Insistence on such reforms is regarded as “interference” in the internal affairs of such nations or outside “dictation” of their policies. The nations with sound currencies are merely permitted—in fact, obliged—to finance the inflationary policies and all the other economic errors of the nations with sinking currencies.

The only real remedy for this fantastic situation would be for the United States to withdraw entirely



from the fund. The articles of agreement themselves permit it to do this “at any time.” At the very least, if the fund is not to end in a disastrous failure, the United States ought to insist on an amendment unequivocally authorizing the managers of the fund to withhold the use of its resources from any nation which in their opinion is following either internal or external policies not conducive to exchange stability.

Among such policies the amendment should list specifically excessive deficit financing, excessive expansion of currency or bank credit, trade discrimination against other member nations, unreasonable exchange controls, a policy of autarchy, of military or diplomatic aggression, and so on.

When governments could no longer have their economic errors subsidized from the outside, at least major follies might be brought to a halt in time. Meanwhile, our government continues to pour out billions of dollars of foreign loans. A great deal of these will certainly never be repaid in full. Not only is our government failing to get really compensating monetary and trade reforms in exchange for these funds, but it is aggravating a domestic boom and inflation, and preparing a corresponding reaction for the future. ❁

They Are the Workers’ Corporations

February 10, 1947

Persistent union propaganda has made most people overlook the most important single fact about the corporations. This is that the chief beneficiaries of the corporations are the workers employed by them. Labor must be paid before it can be determined what funds are left over for either the stockholders or the bondholders. The employees are not only first in priority but overwhelmingly first in the amount they receive.

Let us take as an example the year 1944. It was, with the exception of 1943, the year of highest corporation profits on record. Yet in that year, for every \$1 left over after taxes for the stockholders, General Motors paid out \$8 to its employees. United States Steel \$15, du Pont \$5, Bethlehem Steel \$23, General Electric \$8, Curtiss-Wright nearly \$40, and Westinghouse Electric \$15.

The Department of Commerce found that the employees received 61 percent of all corporate distributions in 1944, and that after deduction of other costs and taxes there were left for net profits 9 percent. The employees, in other words, got from the corporations in

that year between six and seven times as much as was available for the stockholders.

The best data we have shows that the executives of manufacturing concerns get on the average about 6 percent of the total of wages and salaries paid out.

These facts, unfortunately, do not at all correspond with the general public’s idea or the average worker’s idea of the facts. In a recent survey, two-thirds of the workers interviewed actually believed that industrial companies pay out more to the stockholders and to top management than they do to the workers. The typical factory worker, it was found, believes that wages take only about one-fourth of the money paid to workers, executives, and stockholders. The truth is that workers get five-sixths to even higher proportions of this total, depending on the conditions of particular years.

When we consider the stake that business has in this matter—when we consider that the ideas upon which the average worker and the general public act have the power either to preserve or destroy not only individual corporations but the whole private-enterprise system—it is incredible how little business has done to make these basic facts known. Practically all corporations today print reports to their stockholders; only a meager handful print reports to their jobholders. Half of the 50 largest manufacturing corporations do not bother to make public their annual payroll figure, though it is certainly far in excess of their dividend figure. Here is an incredible failure in “public relations.”

For illustrative purposes, I should like to call attention to one of the outstanding exceptions—the Johns-Manville Corp. Last June it published a two-column advertisement in more than 100 mediums throughout the country under the head “A Report to the Public by Johns-Manville.” “Here are the highlights,” this advertisement declared, of Johns-Manville’s annual statement in the critical year of 1945:

Total income	\$886,000,000
For all costs (except those shown below)	41,000,000
To employees for salaries and wages	36,500,000
To government for taxes	3,500,000
To stockholders in dividends	3,000,000
Leaving in the business	2,000,000

These items were then explained in more detail. It was explained, for example, that earnings after taxes were 6 cents per dollar of total income, that wages and salaries were 42½ cents per dollar of total income, that taxes were 4 cents per dollar of total income, and so on.

Within the next few weeks and months the great bulk of the corporation reports for 1946 will be published. This Johns-Manville “jobholders’ report” illustrates the kind of thing that every great corporation should do, first in its own selfish interest, and second in the interest of the whole private-enterprise system, which involves the interest of all the workers. For unless the workers understand the private-enterprise system, and understand what it means for them, they will destroy it. And unless management makes it possible for the workers to understand the system by taking every opportunity to explain the real facts, it will merely be cooperating in its own destruction.

Profits are the form of income that are now under most persistent attack. Yet when we consider the whole economy it is amazing how small profits actually bulk. ❁

## Boom in Mexico

February 17, 1947

MEXICO CITY—Mexico is in the midst of a Florida boom. Real-estate values are fabulous. Prices are high even for Americans. There is a tremendous volume of building. Whether in the middle of the city or in the outlying country, one sees feverish new construction everywhere—new homes, new office buildings, new luxury hotels, new factories. And the new buildings are aggressively and often handsomely “modern.” The Mexican architects are bolder than all but a small handful of our own in handling modernism.

The statistics amply confirm first impressions. Wholesale prices had risen by 1946 about 130 percent above the level of 1939. In the same period the cost of living has risen on various indexes from 170 to 200 percent. Foodstuffs alone have gone up 210 percent. Weekly wages and salaries have not begun to keep pace with this. As compared with 1939 they had risen on the average only 107 percent by 1946.

Among the workers those in the petroleum industry (operated by a government corporation) have done best. In 1946 their average weekly wage was 107 pesos, compared with 81 pesos for the railway workers, 70 for the miners, 58 in the textile industry, and an average of 55 pesos in some 34 other industries. (The peso equals about 20 cents U.S.)

Explanations of the rise in prices and the cost of living are as diverse in Mexico as they are for the smaller rise in prices in our own country. Some Mexicans blame it on the expenditures of American tourists. But though tourist expenditures are estimated in Mexico to have risen on net balance from \$4,000,000 a year in 1938 to \$88,000,000 in 1946, they would not begin to be sufficient to account for what has taken place.

The best-informed thought in Mexico ascribes the inflation to the increase in the volume of money and bank credit. Money in circulation rose from 517,000,000 pesos at the end of 1938 to 1,720,000,000 at the end of 1946. Checking accounts in the same period rose from 224,000,000 pesos to 1,787,000,000. This is a rise of 373 percent in the volume of money and credit from the end of 1938 alone.

There has been no corresponding increase in physical production. Industrial output has been spotty, with spectacular rises in some lines and sharp declines in others. But the general index of industrial production was up in 1946 only 32 percent above the 1939 level. This great increase in the volume of money and small increase in overall production are enough to account for the rise of prices and living costs without looking further.

But the building boom is very real. In the Federal District more than three times as many buildings were completed in 1945 as in 1939. In terms of peso costs the comparison is even more striking. Total construction in monetary values was four to five times as great in 1946 as in 1939, construction of office buildings alone ten times as great, of factories more than eight times as great.

Part of the explanation of this is that building wages and material costs have not gone up as fast as the volume of money in circulation. The index of building-material costs was up in 1946 only 128 percent above the level of 1939. (Mexico, however, had price fixing until the Aleman regime came in December. Official indexes, I am told, do not fully reflect the higher black-market prices really paid.)

In spite of the fact that Mexican price levels have risen much faster than our own, the exchange rate has been kept stabilized at 4.85 pesos to the dollar since 1941. This is even an improvement over the rate of 5.18 in 1939. This stability has been maintained by a stabilization fund and by agreement with the United States Treasury. But the stability of the peso is obviously threatened by basic factors. Mexico’s high prices are out of line with American prices. This threatens the continuance of the growing American tourist trade. It threatens Mexican exports. It unduly encourages imports.

In 1946 Mexico imported 2,637,000,000 pesos worth of goods—five times as much as in 1938.

Yet Mexican exports in 1946 were valued at only 1,384,000,000 pesos (plus about 450,000,000 pesos in gold and silver). It is estimated by some authorities here that a “purchasing-power parity” would today be six or seven pesos to the dollar rather than the present 4.85. ❁

## Mexico's Oil and Export Problem

February 24, 1947

MEXICO CITY—If Mexico is to maintain the present exchange value of the peso and put its economy on a permanently sound basis, it must solve the basic problem of providing enough exports to pay for its necessary imports. In 1946 it imported 2,637,000,000 pesos worth of goods and exported only half as much—1,384,000,000 pesos worth (not including about 450,000,000 pesos in gold and silver). Part of the gap can no doubt be covered by long-term borrowing from abroad, but even this will not be encouraged unless the gap is narrowed.

A large part of Mexico's recent exports reflect a wartime demand that cannot continue. An outstanding example is textiles. Exports of cotton cloth rose from zero in 1940 to 177,000,000 pesos' worth in 1945, and may fall back to zero again.

Mexico's principal hope for future exports, according to the best opinion here, lies chiefly in two sources—petroleum and mining products. Yet the outlook for either is far from promising at the moment. The history of oil in Mexico is a perfect illustration of the short-sightedness of seizure and nationalization.

The American and British oil properties were expropriated by the Mexican Government on March 18, 1938. They were turned over for operation to a semi-autonomous government corporation, *Petróleos Mexicanos*, or Pemex. Incredible as it may seem, this corporation does not publish even perfunctory annual reports. Its operations are shrouded in mystery. The new manager, however, Antonio J. Bermudez, who is highly regarded, has made a few statements within recent months from which a picture of Pemex operations can be pieced together. In 1937, the year prior to the seizure, the payroll of the oil companies amounted to 56,000,000 pesos. In 1941 it had been raised to 91,000,000, and in 1946 to 216,000,000. The number of workers was increased from 13,120 in 1937 to 24,726 in 1946. But this huge increase in personnel and payroll expense has not been matched by any corresponding increase in production. On the contrary, annual production has never since (with the possible exception of 1946) equaled the 47,000,000 barrels

of crude petroleum produced in 1937. Average production in the eight years from 1938 through 1945 was only 40,000,000 barrels.

Even this production has been achieved only by the dangerous practice of over-pumping existing wells, which may mean a loss of part of the reserves. Almost no exploration work has been done to bring in new wells. Yet up to 1936 statistics showed that the average life of a Mexican well was less than eight years. An official report in 1937, advocating the expropriation, itself declared that all the existing petroleum fields of Mexico were about to be exhausted with the exception of those at Poza Rica and El Plan. There is no evidence that Pemex makes adequate depreciation or depletion allowances in its accounts. It is widely taken for granted that its deficits are chronic. In fact, some think appropriations, ostensibly for capital works, were really to cover operating deficits.

Petroleum exports, once the chief means of balancing Mexico's foreign accounts, have declined heavily. This is partly because of the increase in domestic consumption of petroleum, which has increased ten-fold since 1925. Sr. Bermudez recently announced that Pemex was exporting a million barrels of petroleum a month. Yet astonishing as it seems, Mexico has recently been on net balance an importer of petroleum products from the United States.

Mexico's mining problem is similar. Its high-grade metallurgical deposits have been nearly worked out. Virtually no new fields have been brought in since Spanish colonial days. Mining is inordinately taxed. The result has been to drive small producers out of business, to discourage exploration, and to prevent the working of low-grade ores. In 1946, metallurgical production, including gold and silver, was only 60 percent of that of 1929.

Mexico's budget problem, which lies at the basis of the inflation, is far from solved. Federal expenditures for 1947 are estimated at 1,667,000,000 pesos, 72 percent above the average of the war years, and the greatest in the history of the country.

Yet most of Mexico's difficulties are man-made. They can be surmounted by the adoption of more far-sighted policies.

## Chinese Handwriting on the Wall

March 3, 1947

On March 1 the International Monetary Fund, with some 40 members, begins exchange operations. It could hardly start in less promising circumstances. Most of



the 40 nations have sent in the “par value” of their currencies. In very few cases do these official values at all correspond with the values as measured by black markets or free markets. The French franc is officially valued at 119 to the dollar; it has been selling on the outside market at 290 to the dollar. The Belgian franc, with an official value of 43 to the dollar, has been selling on the outside market at 60. The Dutch guilder, with an official value of 2.65 to the dollar, has been selling at 6.75. These are among the “stronger” currencies. The situation in Poland, the Balkans, Greece, and China is incomparably worse.

Yet the fund will buy the currencies of all member nations at par. This means that the relatively strong currencies—above all, the American dollar—will be forced to support the weak ones. It means that the United States will throw away further billions of dollars in buying foreign currencies far above their real values. This type of support by subsidizing the unsound policies of the governments that issue these currencies, postpones the day of reform. For the fund managers are given next to no power to insist on internal fiscal or economic reforms before they grant their credits.

Unfortunately the fund managers, instead of pointing to the dangers of this situation, have sought to rationalize it. “For practically all countries,” they said in a statement on Dec. 18, “exports are being limited mainly by difficulties of production or transport, and the wide gaps which exist in some countries between the cost of needed imports and the proceeds of exports would not be appreciably narrowed by changes in their currency parities.” This is not true. There would be a dramatic change in their trade balance if the currencies of these countries were allowed to sell at their real values. It is precisely because their currencies are ridiculously overvalued that the imports of these countries are overencouraged and their export industries cannot get started.

The current situation in China demonstrates how impotent the fund would be to correct any major decline in a currency. In recent weeks Chinese dollars have collapsed from an official quotation of 3,350 to one American dollar to 18,000 and more on the black market. Of the “stabilization” measures announced by the Chinese Government on Feb. 16 only those designed to reduce governmental expenditures and to increase revenues are likely to be effective. One of these is of outstanding importance. It provides for the public sale to private individuals or corporations, either directly or by the issuance of shares, of all government-operated enterprises except “those necessarily requiring government operation.” This proves that the road to Socialism

is not, as usually supposed, necessarily a one-way street: A return to private enterprise is not merely possible, but simple.

But practically all the other measures announced by the Chinese Government—those seizing foreign assets of Chinese citizens, prohibiting private transactions in American dollars or dealings in gold, forbidding speculation and hoarding, and imposing price and wage ceilings all over again—must only make matters worse. Insofar as they are not evaded they must increase private fears and discourage trade and production. Yet, though exaggerated in extent, these Chinese measures are typical in principle of those now being taken by most countries to “stabilize” their currencies.

The steps by which China or any other country could permanently stabilize its currency would be far different. They would run somewhat as follows: (1) Reduce expenditures and increase revenues; balance the budget. (Engaged as it is in a civil war, this problem for China, however, is today obviously formidable.) (2) Announce that the volume of currency in circulation will not be increased beyond its existing amount. Keep the promise. (3) Remove internal price controls and all restrictions on trading in the currency. (4) Fix a provisional par value for the currency unit—but do not prohibit transactions above or below that value. (The fund agreement actually compels such a prohibition.) And finally, (5) provide for the ultimate conversion of that currency into a definite quantity of gold. ❁

## How England Got That Way

March 10, 1947

England's coal crisis is far from a mere cold-weather crisis. The record freeze hastened and intensified a collapse that was certain to come. It is, after all, a generally known fact that it is colder in winter than in summer. This news, however, seems to have come to England's “long-range economic planners” as a stunning surprise. They are reduced to the humiliation of admitting that everything depends on the weather, and that it is “not feasible so far to give any forecast of conditions beyond noon tomorrow.”

But the British coal shortage was already obvious long before winter set in. The October figures of distributed stocks are crucial. In 1944, these amounted to 18,500,000 tons; in 1945 to 13,800,000 tons; in 1946 to only 10,900,000 tons—the lowest for winter stocks on record.

Behind such figures lies the long-range decline of the British coal industry. In 1913 Britain produced

287,000,000 tons of coal; exports (including bunkers) amounted to 94,000,000 tons—55 percent of all world coal exports. In 1929 coal production was 258,000,000 tons; exports 77,000,000. In 1938 production was 227,000,000 tons; exports 46,000,000. In 1945 production was down to 182,000,000 tons and exports to 8,000,000. In other words, exports had fallen to almost one-twelfth of the former level.

Passing over the results of the coal nationalization program, which has been in legal effect since last July and in formal effect since Jan. 1 of this year, the British crisis is sufficiently explained by the tight network of controls and the chaos of government “planning.” It is impossible to know to what extent that present shortage of miners results from the success of the British labor unions in preventing a free wage market. It is not the absolute level of wages in the coal industry that determines the number of workers attracted to it; it is the level compared with that offered in other lines. But if sufficient British labor cannot be attracted to the mines even by a substantial wage premium, then the obvious remedy is to admit Polish or other immigrant miners who would be delighted to take the work. British controls have prevented either solution.

Great Britain still retains general price-fixing. If it had depended upon free prices as its guide, it is wholly improbable that the present crisis would have arisen. The shortage of coal would have reflected itself long ago in a rise of price. This would have raised a brilliant red light for all to see. Consumers would have been forced, without appeals or allocations, to reduce their demands. Higher wages could have been offered to attract more miners. Imports of coal would have started to Britain long before winter set in. (Our own government still severely limits the quantity and grade of coal that can be exported; so it is only fair to point out that our own “planning” might have prevented this remedy even if Britain’s had been ready to accept it.)

No less serious a cause of the present crisis has been the price-fixing of other British goods. This prevents the British from knowing where their real relative shortages and surpluses are, and from automatically correcting them through the price-and-profit system. One reason why the British people have lost the incentive to work is that they cannot buy what they wish even with the money that their government leaves them after taxes. The economic planners do not trust the people. They tell them in the White Paper that if they are permitted to spend their money as they wish, they will buy “too many luxuries” and “not enough food and clothes and coal; too many toys and not enough children’s boots; too many greyhound tracks and not enough houses”; and

so on. So the British people are treated as wards of the state. They are permitted to have not what they want but what the economic planners think is good for them.

Unfortunately the British people accept this totalitarian view. They are told, and the great majority of them still believe, that the “austerity” program of the Labor government is essential to the country’s economic salvation. It is true that individual austerity is something that most of them probably cannot escape. But the kind of planned and measured austerity imposed upon them by the government is not only unnecessary, but the most serious obstruction to their national recovery. Why this is so, I hope to explain more fully in a succeeding issue. ❁

## ‘Planning’ vs. the Price System

March 17, 1947

The British White Paper, “Economic Survey for 1947,” will repay the closest study by everyone interested in the survival of economic freedom. It typifies the attitude of the most sincere, well-meaning, and intelligent government planners everywhere. It makes no direct attack on the private-enterprise system. It contains, indeed, many statements with which every defender of that system will heartily agree, e.g.: “In the longer view, increased output per man-year is the *only* way to expand production and the standard of living.”

The White Paper decries “theoretical blueprints.” It tells us that the “essential difference between totalitarian and democratic planning” is that “the former subordinates all individual desires and preferences to the demands of the state,” but that a democratic government must “conduct its economic planning in a manner which preserves the maximum possible freedom of choice to the individual citizen.”

The authors of the White Paper seem to be quite unaware, however, of the extent to which their actual plans contradict these announced ideals. We soon find them declaring that “the government must lay down the economic tasks for the nation; it must say which things are the most important.” This means that neither producers nor consumers are permitted to do this for themselves. After repudiating “economic blueprints,” moreover, the authors of the White Paper set their own “targets.” They tell us by exactly what percentage exports must increase in 1947. “Export targets are being worked out for the individual industries to correspond with the global target.” They insist that the government must control imports “tightly,” and they present a “program for 1947” showing just how much food, raw



materials, machinery, oil, tobacco, and consumer goods can be permitted to enter. They have detailed quantitative programs for the production of coal, electric power, steel, railways, shipping, agriculture, building and capital equipment.

The one thing they seem to forget is that under a free price system these problems solve themselves. Production tends to increase most precisely where the greatest relative shortages exist, because under a free price system it is here that the greatest profit incentives are offered.

It is said that less than 10 percent of the British economy is or will be nationalized under present plans, and that "private enterprise" is responsible for the other 90 percent. But at every turn in Britain private enterprise is prevented from functioning. The White Paper itself points to "a large number of direct controls...rationing, raw-material controls, building licensing, production controls, import licensing, capital issues control, etc. Other controls again, such as price control, influence the course of production by limiting profiting margins." The authors, however, give no sign of recognizing the extent to which these controls have reduced and unbalanced production. They talk, on the contrary, as if production could only be kept in balance by their own constant intervention at every point.

Yet such controls are as unnecessary and harmful in the field of foreign as of domestic trade. If American foodstuffs are more essential to British consumers than American movies, they can be trusted to make that discovery for themselves. If you forbid a British consumer to buy an American automobile, he will use the money to buy a British automobile or some other domestic product instead. That will mean one less British car or other home product available for export. Though the British consumer is deprived of what he wants, the trade balance is not improved. In peacetime "planned" imports are needless and foolish, and "planned" exports are still more so. The British must export what foreigners want, not what the government thinks foreigners ought to get.

Under free exchanges all such problems used to solve themselves. If a country bought more from abroad than it sold, it ran short of foreign balances. Equilibrium was usually soon restored by gold shipments or a corrective movement of prices and exchange rates. But price controls, exchange controls, and blocked currencies now prevent all such automatic signals and adjustments. Here is simply one more illustration of how one control brings on an ever-expanding network of controls. ❁

## Foremen under Judicial Legislation

March 24, 1947

Once more, as in the Mount Clemens "portal-to-portal" case, the Supreme Court has handed down a decision that, unless it is quickly nullified by Congress, must do immense practical harm. Once more the Supreme Court affects to be "interpreting" a law when it is in fact amending it. Once more we have a flagrant case of judicial legislation superseding the actual legislation passed by Congress.

In holding that employers are forbidden under the Wagner Act to object to the unionization of their own foremen, Mr. Justice Jackson, speaking for the five-to-four court majority, sets aside the plain wording of the Wagner Act itself: "The term 'employer' includes any person acting in the interest of an employer, directly or indirectly." If foremen aren't put in charge for the very purpose of acting in the interest of the employer, who is?

Yet even if the Wagner Act had gone on to list foremen specifically by name among "employers," it is clear that Justice Jackson's reasoning would have set aside even this. After citing from the law the very definition just quoted, he blandly goes on to say: "Even those who act for the employer in some matters...still have interests of their own as employees." No doubt. But as Mr. Justice Douglas pointed out for the court minority, if on such reasoning, foremen are "employees," then "so are vice presidents, managers, assistant managers...indeed all who are on the payroll of the company including the president."

Though his decision flies in the face of the plain definition in the Wagner Act, Justice Jackson affects to be able to find no other possible interpretation of the law. "It is for Congress, not for us," he solemnly declares, to create exceptions to the present "plain terms" of the Wagner Act. Yet if there were any doubt in the act itself about the intent of Congress, it was completely removed last spring when both Houses of Congress passed the Case bill. This explicitly excluded foremen as employees under the Wagner Act. But this measure was vetoed by the President.

Justice Jackson dismisses the argument of the Packard Co. by declaring: "In other words, it wants to be free to fight the foremen's union in the way that companies fought other unions before the Labor Act." Are these the words of a judge trying only to interpret the Wagner Act as written? Or are they the bitter words of a man legislating his personal feelings?

The unionization of foremen under this decision will do immense harm to production. The foreman

cannot faithfully serve two masters. He cannot act at the same time as the agent of the employer in dealing with labor and as himself a unionized employee hostile to the employer. His divided loyalty to his employer and to his union must go far to nullify the ability of management to manage. It must lead to growing indiscipline and further tension and chaos in labor relations.

The National Labor Relations Board itself, in the Maryland Drydock case, recognized “the dangers inherent in the commingling of management and employee functions.” It acknowledged that unionizing foremen under the Wagner Act would “disrupt established managerial and production techniques.” As Gerard D. Reilly, a former member of the NLRB, pointed out in dissenting in the Packard case, in which the board reversed itself, foremen’s unions cannot really secure their bargaining aims “unless they ally themselves in their policies and tactics with representatives of the employees whom they are hired to supervise.”

But beyond its immediate practical dangers, the foremen’s decision of the Supreme Court majority once more raises a serious constitutional issue. Congress will no doubt now try to undo the harm of the Supreme Court’s foremen decision as it is trying to undo the harm of the same court’s “portal-to-portal” pay decision. But even a new bill faces not only the hurdle of another Presidential veto, but the possibility of still another “interpretation” by the Supreme Court saying that the new law means the opposite of what it says.

If the Supreme Court has unlimited power to say what a law means, even though its “interpretation” flatly contradicts the plain words of that law, then the real power of legislation has passed from the hands of the Congress elected directly by the people to an unelected and irremovable set of nine unpredictable men. ❁

## Six Principles of Foreign Aid

March 31, 1947

During and since the war our government seems to have assumed that it could solve almost any international problem, economic or diplomatic, by the simple process of lending or giving away American money. However necessary financial aid to Greece or Turkey may now be to prevent the further spread of Communist aggression, it could prove worse than futile unless it is recognized to be only a part of a much broader policy or, it might be better to say, reversal of policy. Regarding foreign aid of every kind, it is time we recognized some elementary facts and principles hitherto flouted or ignored.

1—*America cannot feed the whole world.* Before the war the United States produced less than 9 percent of the world’s food supply as measured in calories. Today, as a result of increase in our own production and the falling off of Europe’s, we produce nearly 12 percent of the total. Even this is hopelessly inadequate to fill the gap left by the decline in European production. America has 140,000,000 mouths to feed; but Europe has 350,000,000. It should be obvious that the real solution is not to distribute scarcity but to restore production. This is prevented in Europe everywhere today—by Russian looting, by socialism and Communism, by “agrarian reforms” which seize land, break up farms and displace populations, by export and import barriers, by exchange controls, and by price-fixing which makes it unprofitable or impossible to grow, transport, or sell food.

2—*Food relief and financial help should be extended only on condition that the country aided discontinues policies that discourage or prevent production.* Otherwise the help is worse than futile, and merely prolongs the distress it was designed to relieve. A few weeks ago Yugoslavia “suddenly awakened” to the threat of starvation among 5,000,000 people within its borders. Its new appeal for American aid was properly refused. It is only in planned or Communized economies that such awakenings come so late. In a free economy a prospective shortage would have been made known to everyone long in advance by the movement of prices. The rise in price would have drawn food to the area of shortage, and would have given a greater incentive to every producer to increase his output of food. To send food to Yugoslavia without insisting on reforms would have been not only to subsidize Communism but to perpetuate the very policies that create or intensify the food shortage.

3—*Additional help to any country goes eventually to relieve the LEAST urgent need which that country is able to meet.* This follows from the ability to divert resources. Those that think that if we do not send food to Yugoslavia we starve its people forget that Yugoslavia conscripts an enormous standing army from men who would otherwise work on farms to produce food. To solve Yugoslavia’s food problem by outside gifts is to release the manpower and financial resources to maintain this military establishment. Such aid without stringent conditions would merely support the military threat against our own interests forcing us, for example, to extend more counteraid to Greece.

4—*The function of foreign lending, apart from purely political loans or outright charity, should be restored to private hands.* Though our aid is worse than useless unless extended with conditions, it is difficult and dangerous

for one government to impose conditions on another. Private lenders, however, can do this without arousing international resentment by simply declining, as in the past, to make a loan unless reforms are made in the borrowing country calculated to make repayment probable.

5—*The proposed \$400,000,000 aid to Greece and Turkey need not be a net addition to other foreign aid already contemplated.* In a score of ways we are subsidizing or planning to subsidize socialism, Communism, and strangling government controls throughout the world. These not only reduce production but constitute a further threat to our own free-enterprise system. We can still save most of the nearly \$3,000,000,000 we are planning to throw away in a futile effort to stabilize the overvalued currencies of governments following policies that prevent recovery.

6—*Don't count on gratitude in return for foreign aid.* We didn't get it from Communist Russia even from \$11,000,000,000 of Lend-Lease. Gratitude between nations is too apt to mean "the lively expectation of future favors." ❁

**High Taxes vs. Incentive and Revenue**  
April 7, 1947

In a recent Gallup poll the question was asked: "About how much do you think a married man with two children who earns \$50,000 a year now pays in Federal income taxes?" The typical answer was \$9,000. The actual tax on such a net income, however, is around \$24,000. It would be instructive to learn how many people know that a \$300,000 net income shrinks to \$66,000 after taxes and a \$1,000,000 income to \$161,000.

In its March letter the National City Bank publishes some illuminating income-tax tables. One of these shows how much is actually left at various income levels for the taxpayer himself out of every extra dollar he earns. The figures are for a married man with two children and legal deductions of 10 percent of his gross income.

When the Gallup poll asked people how much they thought a man who earns \$50,000 a year ought to pay in income taxes the median average answer was \$7,500. This is only about a third of what such a man actually does pay. The taxpayer is allowed to keep less than half of everything he earns above \$22,000. The question of "fairness," however, is one on which it seems impossible to get agreement. No matter how much is taken from the big incomes, some people cannot see why those who

earn more than they do should be allowed to retain any amount higher than they themselves can earn.

Gross Income	Taxpayer keeps out of each additional dollar
\$2,000	\$1.00
4,000	.81
8,000	.75
16,000	.59
32,000	.41
64,000	.29
128,000	.15½
350,000	.13½

It seems more profitable from a pragmatic standpoint, therefore, to consider not so much the "fairness" of the tax structure as its practical effects on the economy. One obvious effect (considering the present corporate as well as personal income-tax structure) is to soak up the principal sources of capital funds. The funds that the present tax structure takes are precisely those that would have gone principally into investment—that is, into improved machines and new factories to provide the increased labor productivity which is the only permanent and continuous means of increasing wages.

An even more important effect of taking so much of the taxpayer's earnings is to diminish or remove the incentives to bringing such earnings into existence in the first place. This means not merely a loss to the taxpayer who does not trouble to earn the money. It means a loss to the wealth of the whole nation. It means a loss even to the Treasury itself. Another table compiled by the National City Bank, based on reports of the Bureau of Internal Revenue, strikingly illustrates this result. (The dollar figures stand for millions of dollars.)

	1926-28 average	1942 average
National income	\$77,000	\$122,000
Incomes over \$300,000		
Total amount	\$1,669	\$376
Taxes paid	\$281	\$292
Top tax rate applicable (%)	25	88
Number of returns	2,276	654



Let's see what this means. During the same period that the total national income *increased* 58 percent, total incomes over \$300,000 *fell* 77 percent. If each individual's income had risen by the same percentage, total incomes over \$300,000 would have risen by a much greater percentage, for all incomes previously above \$190,000 would now be counted among the incomes over \$300,000. Yet even if the aggregate of such incomes had risen no more than proportionately to the whole national income, the total would have reached \$2,637,000,000—seven times greater than it actually was. And if this income had been taxed at the same schedule as in 1926–28, with a top tax rate of only 25 percent, the yield to the Treasury would have been about \$444,000,000.

It would have been, in other words, about 50 percent greater than the actual yield from the greatly reduced incomes taxed at a top rate of 88 percent. For there can be little doubt that overwhelmingly the most important reason for the contraction of incomes over \$300,000 in 1942 compared with 1926–28 was precisely the increase in the top personal income-tax rate from 25 percent to 88 percent. In other words, there can be little doubt that a sharp reduction in the top tax rates prevailing today would eventually greatly *increase rather than reduce revenues*. ☼

## Our Fiscal Irresponsibility

April 14, 1947

In the present temper of the country, and under our political setup, the champions of government economy labor under a heavy handicap. They work first of all against the implicit assumption that the burden of proof is on those who wish to economize to point out exactly where and how they would do so. The burden of proof, on the contrary, must always be on those who are asking for the appropriations. They should be made to justify affirmatively every dollar of expenditure they propose.

It is right here that we encounter the first great dilemma of budget-making. Only those asking for the money are in position to know intimately how much is really needed. Yet these are precisely the persons whose personal interests are most directly involved. Their usual interest is to obtain as large an appropriation as possible. And the farther away any official is from the point of origin of the request the less he can know at first-hand about its justification. Requests for Army funds may be filtered up from captains to colonels, colonels

to generals, generals to procurement officers or an Assistant Secretary of War, from him to the Secretary, and thence to the Budget Bureau or the President. Each in turn must rely in large part upon the word and judgment of his subordinates.

It follows from this that even a very conscientious and economy-minded Bureau of the Budget can do only a partial job of screening out wasteful and unnecessary expenditure. It can only cut down or eliminate the items that look excessive or wasteful on paper or in replies to questions. And what a conscientious Budget Bureau can only do inadequately by working full time, Congressional appropriation committees, without such a conscientious Budget Bureau, must do far less adequately. Their so-called investigation is too often perfunctory. They cannot hope to do this task well unless they are assisted, not only by a staff of full-time experts who know what questions to ask the department heads requesting money, but by field examiners who can see for themselves how money has been, is being, or could be spent.

If the appropriation committees, acting half-blindly, go into a huddle and emerge with a proposed slash of \$6,000,000,000, or 16 percent off the amount that the President has requested, without publishing in detail the wheres and whys of their cuts, they find their well-intended efforts denounced from all sides.

The department heads who have asked for the appropriations accuse them of “undermining the national defense,” or torpedoing foreign aid, housing, social security, or what-not. Newspaper editorial writers who are not in a position to know the real facts join in the clamor. Their usual line is that the President must be supported. They forget that even the President has been obliged to rely for his estimates on many anonymous and not disinterested subordinates. The beginning of any Congressional budget control would consist in the establishment of an adequate staff of experts to act as the eyes, ears, and legs of the Congressional appropriation committees.

But we shall never have any real fiscal responsibility at Washington without far more basic reforms even than this. The first of these would be to adopt the wholesome rule that has prevailed in Great Britain since the time of Queen Anne—to wit, that the legislative body cannot make any appropriation whatever not recommended by “the government.” Only such a rule can prevent raids on the Treasury by Congressional logrolling. Only by making the executive solely responsible for the budget can there be a responsible budget.

The proper function of members of Congress is to act on behalf of the people as watchmen of the Treasury. They cannot be suitable guardians of the public till as long as they are themselves permitted to stick their hands into the till. The proper use of the legislative power of the purse is to deny the purse to the executive for wasteful or unjustified expenditures. Congress will do this best only if it is itself removed from the temptation of trying to buy votes with the people's money. It will be a vigilant watchdog only if it is itself denied access to the Treasury. As Henry Jones Ford has put it: "There is no propensity of human nature more marked than jealousy of opportunities that one does not share." ❀

## The German Paralysis

April 21, 1947

GENEVA—This former seat of the League of Nations is still the best listening post in Europe. Bordered by Germany, Austria, Italy, and France and speaking the languages of all, Switzerland is the meeting place of nationals who have penetrated the curtains of its frontiers to say the things it is useless or dangerous to say at home. The most ominous situation that emerges from these reports is that of Germany.

The comfortable assumption of most of us has been that the sickness of Germany and Europe is a temporary consequence of war destruction and will be cured almost automatically by the passage of time. But closer examination makes it clear that prostration has been brought about mainly by postwar governmental policies and that it grows worse, not better, every day. The economic chaos in Germany is the product of many causes—war and postwar destruction, Russian and other Allied seizure, displacement of populations, dismemberment of the country, watertight political and economic zones, the level-of-industry plan, and currency inflation, which is wholly out of control.

In addition, there is one cause as important as any of these, though it has so far received amazingly little outside attention. When the occupying powers took over Germany, they accepted virtually the whole existing Nazi system of economic controls. This included the Nazi device, imitated by the whole world, of great monetary inflation on one hand with its normal consequences prevented on the other by a system of price, wage, exchange, and production control.

Such a repressed inflation not only destroys all economic liberty but is far more harmful in its ultimate economic consequences than an open inflation. It removes all incentives; it deprives the price system of its whole function in directing, allocating, and synchronizing production as among thousands of different goods and services.

The result has been an appalling waste of manpower in Germany. There is full employment, with millions of people wastefully and wrongly employed under German planned economy. Wages, prices, and rents are purely nominal, and almost no activity is permitted except by special official license. The available food rations are so small nobody can live on them. Workers are paid in useless marks. Under these conditions a primitive barter economy has grown up outside the planned economy. True German currency consists of brandy for large transactions and cigarettes for small ones. City workers must devote an increasing part of their time, at the expense of their regular jobs, to home gardens. They are officially encouraged to do what is officially prohibited in the French zone.

Textile firms and makers of kitchen utensils are legally required to pay workers 10 percent of their wages in goods, but after a few weeks these are useless except to barter for food stuffs which are supposed to pass through official markets at official prices. So workmen spend their weekends in cycling or trudging many miles into the country to bring back a few wretched potatoes. Potatoes are actually exchanged singly. Apart from any other aspect this is an appalling waste of labor. German industry entered the postwar period with high stocks of raw materials put aside for this purpose. German production in the last two years has been living on these stocks. They are now nearly exhausted. Where German producers are paid in marks at official prices, the worthlessness of these marks and official restrictions prevent them from replacing the raw materials they have used up. This threatens a further drying up of production. Until it is cured through currency reform, a return to free markets, and foreign exchanges and credits on a commercial basis, the German paralysis at the heart of Europe must drag down the rest of the world.

As the recent Hoover report has pointed out, American and British taxpayers are contributing nearly \$600,000,000 a year to prevent the Germans from starving simply because the Germans are prevented from producing for themselves. This has contributed to the serious European shortage of fertilizers and coal. "The whole economy of Europe," as Mr. Hoover



declares, “is interlinked with German economy. . . . The productivity of Europe cannot be restored without the restoration of Germany as a contributor to that productivity.” ❁

Switzerland as a World Mirror

April 28, 1947

GENEVA—The traveler in Switzerland, if he depended on first impressions, could easily imagine himself in a paradise of peace and plenty. Physically untouched by the war, incredibly neat, with every utilizable square inch of soil seemingly under cultivation, the whole Swiss countryside looks like one enormous golf course that has just been rolled and mowed, and the tourist, though he may sometimes have trouble getting sugar or butter, is extremely well fed. True, he must present ration coupons in restaurants, but he seems to get all that he can use in the cities. Stores display a surprising variety of quality goods. Industry also seems prosperous.

Switzerland exports 90 to 95 percent of its entire production of watches, about half of which go to the United States. Switzerland is actually compelled to ration its own exports in money values (though not quantity). Its exports of watches are at record levels. They rose from 195,000,000 francs' worth in 1939 to 492,000,000 francs' worth in 1945.

But beneath this smiling surface, Switzerland has her serious problems. Rations for Swiss families are more severe than those for the tourist. There are separate rations for sugar, jams, pastry, flour, cheese, butter, lard, meat, bread, and milk. Wholesale prices have more than doubled since 1938. The cost of living has risen in the same period more than 50 percent in spite of price controls which hold down rents to the 1939 level. The inflation is reflected in the rise in bank-note circulation from 1,700,000,000 francs at the end of 1938 to 4,100,000,000 at the end of 1946. The budget is still out of balance.

A great problem in a small industrialized country like Switzerland is that, in a world of super trade barriers, it is absolutely dependent on foreign trade. It must export or die and import or die. The basic function of its exports is to buy imports. Yet, though the present demand for its exports is unlimited, Switzerland is cut down to about half its prewar supplies of coal. It is short of raw materials. It is forced to make bilateral agreements with other nations.

To supply its essential import needs, it insists that nations receiving credits from it use part of the money to buy some of its luxury products as well as the machinery they need. Where these special bilateral agreements do not exist, it obliges each private trader to develop his own bilateralism. The exporter must arrange an approved import equal to his export and the importer an approved export.

Switzerland is almost the only country in the world today where it is both legal and respectable to deal in foreign currencies at the reevaluations put on them by buyers and sellers. These Quotations are published daily in the newspapers. As the convex mirror of an automobile focuses a large world in small space, the Swiss market in foreign banknotes gives a miniature survey of the currency chaos.

This market certainly reflects the local supply and demand situation in these banknotes. There is more dispute concerning the extent to which it reflects their real values. Is there, for example, a real discount on the American dollar or only a temporary one due to special conditions in Switzerland? The question is difficult to answer with confidence, yet discounts on other currencies seem to reflect rather accurately the known general conditions. Here are quotations in Swiss francs on April 14 of some outstanding banknotes compared with their official rates:

	Market	Official
Dollar	3.65	4.30
Pounds sterling	10.65	17.34
French francs (100)	1.70	3.60
Italian lire (100)	.55	1.91
Belgian francs (100)	6.90	9.90
Dutch guilders (100)	60.00	162.00
Swedish kroner (100)	85.00	119.50

It will be noticed that the free dollar, or what the Swiss call the financial dollar, is selling in Switzerland at a discount of about 15 percent. The reasons for this are too complex to go into here, but the situation has some strange results. The Swiss National Bank will exchange up to \$125 a week for American tourists, converting travelers checks into Swiss francs at the official rate of 4.30. It is then perfectly legal for the tourist to go

around the corner and buy dollar bills with the francs at the rate of 3.65, thus coming out with nearly \$150. As the first part of the transaction is recorded on his passport, however, he can't keep pyramiding the deal. ❁

## France on a Quiet Volcano

May 5, 1947

PARIS—Some experts here tell you that the key to France's economic problem is coal; others insist that the real key is currency. Certainly, both problems strike the visitor on his first day. Shortage of coal means shortage of electric power. At night the streets of Paris are dark. The currency chaos is equally evident in the bundles of ill-assorted bills one is forced to carry in denominations ranging from five to one thousand francs each. An unpretentious restaurant meal costs around 500 francs; a really good meal, 1,000 francs and up. At the official exchange rate, this means from about \$4 to well above \$8. Even translated at the present black-market rate of slightly less than 200 francs to a dollar, meals and most items of clothing soar far above New York levels.

The franc has an internal purchasing power on official indexes of less than one-eighth its value in 1938. Allowing for black-market prices, foodstuffs are more than thirteen times as high as in 1938. Today, the franc is worth only one-fortieth of what it was in 1914 in terms of dollars, and perhaps only one-hundredth in terms of goods. This long-term decline has meant the steady erosion of the French middle class, with its conservative capitalist psychology and traditional habits of thrift.

The budget continues unbalanced. The volume of money in circulation continues to mount. Prices, especially of foodstuffs, mount with it. The Blum orders for a 10 percent reduction in prices caused a momentary arrest in this upward movement. But for the most part French price controls are ignored or evaded. Where some of them are seriously enforced they disrupt deliveries and distort production. Farmers are called upon, for example, to deliver all their wheat above certain deductions for seed and farm consumption to authorized agencies at official prices. But the price of wheat is fixed too low in relation to actual prices received for meal or other cereals. The result is that farmers have been wastefully feeding wheat to livestock. This reduces the amount available for direct human consumption and adds to the difficulties arising from the destruction of one-third of France's sown wheat by last winter's frosts.

The great official overvaluation of the franc has made many imports cheap in terms of francs, but French exports, including tourism, are very high priced in terms of foreign currencies. This reduces and discourages French exports. It makes France more dependent on outside loans, principally from the United States, to continue its imports.

Despite such policies, some lines of production have recovered astonishingly. Iron and steel output in February are 85 percent of the 1938 average, but 180 percent of the output in February 1946. Automobile output in February was 80 percent of the 1938 average and almost double that of the corresponding month in 1946. Production of coal in February was actually 108 percent of the monthly average in 1938 and is now around 115 percent. But France normally imports about one-third of its coal, and coal imports in February were only 34 percent of the 1938 figure. Coal is still the chief bottleneck in French production.

High hopes are placed by the French in a plan drafted by Jean Monnet, which was approved by the Blum Cabinet in January. It calls, among other things, for a balanced budget, a 48-hour week, and modernization of "key resources"—coal, electricity, steel, cement, agricultural machinery, and transport. But the political obstacles to its serious application are great, particularly as concerns the budget. It depends also on substantial credits from the United States.

The fate of French economy rests today mainly on political factors. The chief of these is the strength of the Left, above all of the Communists. Communists occupy key posts in the government. They dominate the most powerful labor union, Confédération Générale du Travail. For reasons of international policy, Communists now play "conservative," work for increased labor output, restrain wage demands, discourage strikes, sometimes even break strikes; but these tactics may be reversed at any moment. The French are no longer defeatist in spirit. But they live like inhabitants of a town built on the sides of a volcano, speculating uneasily in sidewalk cafes on the meaning of the rumblings beneath their feet. ❁

## Belgium: Experiment in Freedom

May 12, 1947

BRUSSELS—It is only an hour's airplane trip from Paris to Brussels, but in that hour one passes from shortage to comparative plenty. The most dramatic evidence comes at night, when the streets are ablaze with electric signs, contrasting with the blackness of Paris or

London. Belgium's output of electric power in March was 80 percent higher than the rate in 1936–38. This in turn was made possible by a coal output ranging from 85 to 90 percent of prewar levels.

In Belgium, as in France, the complaint is that coal is the great limiting factor on production. Yet an index just prepared by the newspaper *Agence Économique et Financière* gives Belgium's overall industrial production as 108 percent of the prewar level in March, with an estimate of 112 for April. This compares with an index for France of about 88 percent of the prewar level and for Holland of about 80.

Comparative plenty is also found in the stores. There is a wide variety of imported clothing. Nylon stockings have actually become a glut on the market. Cigarettes seem plentiful. In restaurants one has little trouble getting coffee, tea, sugar, butter, California oranges, and other fresh fruits. For Belgium has deliberately followed a different policy from that of its French and British neighbors. It has not discouraged or prevented imports.

The Belgian authorities figured correctly it was worth risking a shortage of foreign exchange in order to stock up adequately with materials for industry, to "fill the workman's belly," and to give production incentives to their people. The policy has paid handsome dividends. Belgium has not lost exchange, though the statement of the National Bank of Belgium for April 17 shows a decline of 5,716,000,000 francs in gold compared with the corresponding date a year ago. It shows a compensating increase of 5,135,000,000 francs in foreign exchange holdings.

Belgium has sought to deal with inflation through its causes rather than by trying to suppress its symptoms and results. Immediately after the German occupation, the government mopped up a huge excess of outstanding currency to prevent any further inflationary effect. The authorities boast that since the end of 1945 they have been able to prevent the total supply of money from increasing. There is still a heavy budgetary deficit, however, and this problem is far from solved. Yet the country has been remarkably successful in holding up the value of its currency, which has actually gone to a premium over the British pound on the outside market. This spectacle—together with governmental pledges against nationalization or new taxes on capital—has increased Belgian confidence and led to the voluntary repatriation of Belgian funds from abroad.

The Belgian Government has been working hard for the reduction of foreign trade barriers. It has removed almost all restrictions on imports. This policy is no doubt inspired by self-interest. Belgium is a

"transformation" country heavily dependent on foreign trade. But the policy is also farsighted. Just as foreign exchange controls force domestic controls and vice versa, so external and internal free trade go together. Since early 1945 Belgium has been steadily relaxing price controls and rationing. In any case, it seems unable to enforce controls. It is estimated that about 80 percent of all Belgian agricultural products go through the black market.

The desire of Belgians for freedom of trade has led to perhaps the most heartening single development in the whole of Europe. This is the pending customs union between Belgium, the Netherlands, and Luxembourg. The agreements, already signed by representatives of the three governments, now await ratification by their legislatures. They contemplate adoption by Belgium and Holland of identical tariff schedules, designed more for revenue than for protection, and the gradual elimination of trade barriers between the two countries. When this union has been completed, "Benelux" will be the greatest foreign trading market in the world next to Britain and the United States.

But the real importance of the union is symbolic. When other countries are rushing toward more economic nationalism, tighter trade controls, and dreams of autarchy, when they pay freedom of trade chiefly lip service, Belgium and Holland are getting a model for action. ☸

## Austerity in Holland

May 19, 1947

AMSTERDAM—Holland suffered far more from the war than Belgium did. The Germans had to evacuate Belgium in a few days without time to destroy. Holland was occupied for months longer. Rotterdam and other cities had been ruthlessly bombed; the retreating Nazis systematically demolished houses, factories, power plants, railroads, and bridges. They systematically looted cattle, farm equipment, locomotives, cars, barges, cranes, thousands of industrial machines, and scores of factories, including a complete steel mill and Holland's sole aluminum plant. They broke the dikes and flooded the land. Holland, which had had one of the highest living standards in the world, lost more than 40 percent of its productive capacity. Industry was paralyzed. It had to start again from the bottom.

Holland has lost also, as a present source of income, the Dutch East Indies, with more than seven times the population and more than 50 times the area of the mother country. It has lost Germany as its largest single



source of supplies and second largest customer. Half the machines used in Holland are of German origin. With Germany an "economic desert," broken or worn parts cannot be replaced and whole machines become useless. For good or evil, the economy of Holland depends heavily upon that of Germany. The Dutch do not carry their hatred of the Germans, as some of them put it, "to the point where we want to cut off our own right hand."

When one keeps this history and situation in mind, the extent of Holland's recovery is amazing. A miracle of reconstruction has been wrought on the railways. Destroyed bridges have been rebuilt. The rubble of bombed towns has been cleared away. Housing progress has been made despite shortages of wood and glass, which must be imported. The inundated ground is dry again; the dikes repaired. Most of the flooded land has been brought back to cultivation far earlier than anyone had dared hope.

The Dutch Government has embarked on a program of national austerity. The motto is: "work hard, consume less, save more." A factory, indeed, is not allowed to set a work week of less than 48 hours without special permission from the government. The unions have accepted a wage freeze. A tax running up to 90 percent has been imposed on all increases in capital value during the war even though these are measured in depreciated guilders. A bill now under discussion will impose a general capital levy of a smaller percentage.

The Netherlands economy is tightly controlled inside and out. Every import and export requires both a foreign-exchange permit and a special permit. Rents are frozen. There is strict price control and rationing of food, clothing, and cigarettes. Membership in a trade group is compulsory in every firm. Raw materials are allocated on the basis of use in 1938. No new firm may be started and no existing firm expand without a special license obtainable only if it can prove "need" for its own existence.

Businessmen complain that controls have been multiplied to a point where no one any longer understands them. Initiative is smothered. Even the traditional Dutch integrity and respect for law crack under the strain. As every business firm depends for its very existence on the good will of some civil servant, the inevitable result is the emergence of corruption. People complain that the rations are too small. Black markets have developed in cigarettes, eggs, gin, butter, meat, clothing and ration coupons.

There is heavy smuggling between Holland and Belgium, which is uncontrollable because the border runs through village streets and even houses. Austerity has been driven to a point where it undermines effort.

People lose the incentive to work when they cannot buy what they want with the money they earn.

Holland tries to solve its formidable exchange problem by separate bilateral agreements with more than a dozen countries, but all such agreements undermine a free multilateral market and the freedom of consumers. Though Holland, like most of its neighbors, regards these bilateral agreements as a temporary expedient, they are tying themselves into an entangling web from which extrication will not be easy. The expedients they adopt perpetuate the very conditions they are intended to cure. ☸

## The Middle Way Swings Left

May 26, 1947

STOCKHOLM—Neutrality has obvious advantages. You are struck by the freshness and brightness of Stockholm, its nocturnal wealth of neon lights, its rich display of goods, its fine food, and not least of all by the clothes of its men and women, so much newer and smarter than one finds elsewhere in Europe.

The net effect is one of prosperity and opulence. Industrial production is in fact 30 percent above that in 1935 and at the highest level ever reached in spite of the shortage of coal and constant complaints of the shortage of manpower. The money value of foreign trade last year broke all previous records. Many firms have enough orders on their books to keep them in full production for years to come.

Yet there are signs of serious trouble ahead. On March 15 the government suddenly imposed a licensing system to curb nonessential imports, among them motorcars, fruits, and coffee. The public was jolted by the re-imposition of coffee rationing. These measures were taken because of the alarming reversal in Sweden's trade balance. An export surplus of 674,000,000 kronor in 1945 had turned into an import surplus of 842,000,000 kronor in 1946. Though exports had actually mounted from 1,757,000,000 kronor in 1945 to 2,529,000,000 in 1946, imports more than tripled, jumping to 3,370,000,000 kronor. A great part of these imports represented not the coal, oil, and raw materials that Swedish industry is so eager to get but consumer luxuries. This meant an alarming drain on the central bank's gold and foreign exchange reserves, which dropped from 2,973,000,000 kronor last June to 1,364,000,000 by March 15.

This result is generally blamed here on the freedom of private individuals to import. It is, however, a

perfect illustration of how one control makes another necessary until nothing can be left alive. Last July, following Canada, Sweden revalued its currency upward by about 16 percent because it feared an American price rise. By making its imports cheaper, however, it simply encouraged an increase in the volume bought. The government, moreover, held down the export prices of timber, pulp, and paper below the world market and so reduced the amount of foreign exchange that Swedish exports could bring in. Its rigorous internal price fixing more importantly left “an inflationary gap” between the supply of money and the supply of goods at official prices. The excess money naturally flowed into abnormal purchase of imports. Under free exchanges the situation might have corrected itself automatically by a fall in the krona, making imports more expensive and exports more profitable. But in Sweden, as elsewhere, it is illegal to buy or sell currencies in accordance with the values established by supply and demand and no self-adjustment takes place.

Sweden has bilateral trade treaties with nearly every country in Europe. These also create inflexibility. Sweden is bound to take luxury import quotas from treaty countries. A sudden import ban must therefore hit principally American exporters because the United States has not taken part in the bilateral-treaty game.

The recent outflow of gold and exchange reserves was most disturbing, however, in connection with the huge volume of foreign loans and credits extended by Sweden. Part of these went to Norway, Denmark, Finland, and Holland, as Sweden’s contribution toward rebuilding Europe. Part were extended to facilitate Swedish exports. Hardest to explain from Sweden’s standpoint is its loan to Russia. This reaches 1,000,000,000 kronor, bringing the total of Sweden’s foreign credits to 4,500,000,000. Comparing population and national incomes, this total would be equivalent to at least \$45,000,000,000 from the United States.

The Russian credit is variously explained as good-neighbor policy, a substitute for vanished German trade, and an anticyclical measure. But it means, in the next few years, a tremendous drain of unrequited exports.

A final factor in the Swedish trade picture is the actual and potential flight of capital. Social Democrats of the Swedish labor party are in power. Wartime government controls have not been appreciably relaxed. There are rumors of devaluation of the krona. There is fear of further socialization. The combined income and capital taxes are almost confiscatory. And the

threatened flight of capital brings hints of even more stringent controls. ❁

## England vs. the Price System

June 2, 1947

LONDON—England’s major economic troubles today seem not so much the result of its war losses, appalling as these were, as of its postwar policies. Temporary impoverishment was inevitable, but the postwar series of special crises in coal, food, and dollars was not. The underlying assumption beneath the present strangling network of economic controls is that a free market and price system is at best a fair-weather system, a luxury a country can afford only when it is already well off. It is the precise function of free prices, however, to allocate production among thousands of different commodities and services and to relieve the most serious shortages most quickly by providing the greatest profit and wage incentives precisely where those shortages exist. A free price system last fall would certainly have signaled the impending shortage of coal long before the Labor government was awake to its existence. It would have encouraged imports of coal from America then, instead of waiting until now. It would have enabled higher wages or bonuses to be paid for increased production. It would have attracted more men to mining. If the miners had been free to spend their money for things they really wanted, higher money wages would have meant higher real production incentives.

On May 7 Emanuel Shinwell, the Minister of Fuel and Power, indiscreetly declared before a meeting of union delegates that “the organized workers of the country are our friends; as for the rest they don’t matter a tinker’s cuss.” This statement, which has since become a source of great embarrassment to the Labor party, does supply a key to the real nature and animus of recent British planning. The essentially collectivist and egalitarian philosophy behind it begins to emerge more clearly. A ceiling has been put on imports and particularly on the purchase of so-called luxuries because “dollars are short” and “we cannot afford it.” But who are “we”? Certainly not the individual who wishes to buy.

The real principle applied here is “If I can’t afford to buy it, you shan’t be allowed to buy it. If organized labor cannot have it nobody shall have it.” This is most clearly illustrated in food. The overall food supply is not nearly as bad as is commonly supposed. Though it lacks interest and variety, the Minister of Food estimates in terms of calories it is only 6 percent below the prewar level. But analysis of its distribution is instructive. In



April wage rates in Britain were 68 percent above their 1939 level. Weekly wages were about 80 percent higher. The cost of living index, however, has gone up only 31 percent. Food considered separately had risen only 22 percent. This means that the average British worker is considerably better off in terms of goods than he was before the war.

One can say that this is a very good thing, but one cannot argue at the same time that production is low because nutrition is low (the coal miner in particular gets a much higher than average allotment) and one cannot call it austerity. Austerity is not being imposed on the British nation as a whole; it is being imposed through heavy taxes on the British middle and upper classes to subsidize the British working class.

Food prices are being subsidized to the extent of \$1,572,000,000 a year in spite of the fact that the British worker is spending a much smaller percentage of his income for the same amount of food than he did before the war. It is the middle and upper classes who have now been reduced to something approaching the workingman's diet.

Insofar as austerity has been imposed on the whole British people, it consists in refusing to permit either consumers or producers freedom of choice. The consumer is not free to spend his money on things he himself wants but only on things government officials think are good for him. The producer is not free to make what he wishes but only what government officials think is good for the country.

The whole system of priorities, allocations, quotas, and licenses causes endless delays, keeps efficient concerns from expanding, and keeps inefficient concerns in business. Production is lost all around not merely because an army of men is created to issue orders rather than produce, but because producers themselves must spend so much of their time trying to get licenses and allocations instead of finding out how to reduce costs and prices and make the goods consumers really want. ❁

## Why Europe Is in a Mess

June 9, 1947

NAZISM was defeated in war. Hjalmar Schacht, the Nazi economic wizard, is in jail. But when Schacht and his surviving comrades survey the world today, they must feel consoled. Intellectually Schachtism has conquered Europe. The system of price control, wage control, profit control, interest control, exchange control, foreign-trade control, bilateral treaties, rations, priorities, allocations, quotas, with a special license required

for almost every move, and with a mounting currency inflation hidden and repressed by these devices—this is Schachtism. And this is the system which nearly every country in Europe has now embraced. If it does not repudiate outright the free-market and free-price system, it regards that system as a luxury that it may be able to afford after its recovery has already been achieved.

The central economic problem of the world today is Europe, and the central economic problem of Europe is Germany. Yet in Germany the looting, the “level of industry” plan, the combination of a chaotic currency with legal prices and wages far below what a free market would bring, destroy production and all incentives. In misdirected efforts to prevent Germany from again becoming a menace to the world we have made it a burden to the world.

It should be possible to prevent it from becoming either—by permanent supervision, by forbidding war production, by permitting full peace production, by setting up a stable currency, by abolishing the whole system of price and wage control, allocations and licenses, by imposing reparations up to the point where they do not endanger output or disrupt world economy, and finally, by *forcing* on Germany entire freedom of trade with other nations.

This last policy, the opposite of Hitlerian autarchy, would make Germany heavily dependent on imports at the same time as it would increase world efficiency. To protectionists and government planners and socialists, it should be pointed out that from their point of view it ought to be the worst of punishments to deprive Germany of protection and planning and socialism.

It is precisely because Germany exhibits a bankrupt Schachtism in extreme form that it is so instructive an example. But elsewhere the same disease is illustrated in milder forms. Let us take a sort of composite photograph, and call it Ruritania. The situation in Ruritania will be found to apply with only minor modifications to most of the countries of Europe.

Ruritania's budget is unbalanced. Heavy sums are being spent on armaments, on food subsidies, and on increasing pensions, family allowances, and other forms of social security—but obviously, the government points out, none of these expenditures can be reduced. Tax rates have been kept up or increased on the higher incomes. A capital levy has been added. Further nationalization is discussed. Sales taxes on luxuries, with one or two exceptions, have been reduced.

It is surely not the finance minister's fault if these arrangements are not bringing in more revenue. Meanwhile the volume of money in circulation has

risen enormously and is still rising. The government, however, is holding down interest rates so that it can borrow cheaper and encourage business borrowing. The policy also increases the inflationary pressure, the volume of money and bank credit, and ultimately the government's general expenditures; but about this nothing is said by government spokesmen.

But if the government is creating inflation, it is determined to prevent the unpopular consequences of this inflation. It blames all price rises, not on its own inflationary policies, but on the greed and rapacity of producers and sellers. It fixes ceiling prices on everything. Holding down prices to arbitrary levels of course dislocates all profit margins. But as goods are produced in accordance with relative profit margins there is a huge misdirection and waste of capital and labor. Necessities are underproduced; luxuries are overproduced; there are universal complaints of "labor shortage."

Where inadequate profit margins discourage or prevent production, and where prices fixed below the market over encourage consumption, an attempt is made to correct the situation by rationing, arbitrary priorities, and allocations. The shortages brought about by bad price control are treated as inescapable and inherent. As all output is interdependent, production all around is slowed down to that of the item in shortest supply, whether coal or timber or "labor."

Price control economically necessitates wage control; but wage control in turn politically necessitates price control; and no one knows how or where to break out of the circle.

On its foreign trade Ruritania imposes controls made necessary by, and in turn necessitating, its internal controls. The country has an inflation and wishes to conceal it. It does this internally by price fixing. But one consequence of this is that the volume of money is kept in excess of the total volume of goods at official prices. This produces the "inflationary gap"—i.e., the amount of money or money incomes with no outlet.

If imports are allowed to come in freely, all this excess money, as Sweden discovered, will be used to buy them. Yet Ruritania wants imports of raw materials and machinery, and wants to get them as cheap as possible. It can do this by keeping its official exchange rate arbitrarily high and making it a crime to buy or sell its currency below this rate. This makes foreign goods cheap in terms of its own currency; but it also makes its own export goods extremely, if not prohibitively, expensive in terms of foreign currencies. The high rate for its currency, in short, encourages imports and discourages exports. It is also likely to make the American traveler feel that he is being swindled by the obligation to

convert his dollars at the official exchange rate, and so provokes resentment and discourages tourism.

Ruritania tries to cure all this, not by allowing its currency to seek its natural supply-and-demand level, but by refusing to permit any import to come in except by special license. It orders manufacturers to set aside specified goods for export and forbids its own citizens to buy at any price the goods set aside for export.

The result of refusing to permit its own citizens to buy "luxury" imports with their own money, however, is to hurt the luxury export trade of all other countries. Yet each European country has its own luxury exports which it is eager to push to get dollars or other exchange to buy necessary imports. France has its wines and brandies, perfumes and laces. Holland has its tulip bulbs and fancy cheeses. Switzerland has its embroideries and resort hotels. Each argues that it is unsound and unrealistic to expect people in these trades to turn to other work. Their capital and long-acquired skills are irrevocably invested in what they are doing. It is often a way of life inherited from their fathers and grandfathers. To force them into other lines would involve huge losses and radically dislocate the whole national structure of production. So each country tries to force other countries to take its luxury exports while refusing to take theirs.

The stalemate is broken by bilateral trade treaties in which each country forces its neighbor to take some of its luxuries along with its necessity products. These treaties, however, do not merely leave matters where they would have been under freedom of trade. Both necessities and luxuries are exchanged against each other at artificial prices which do not have to meet world competition. Each country is forced to take, not the goods that its consumers want, and in the proportions that they want them, but the luxuries that its neighbor is most eager to get rid of.

Bilateralism is politically popular because its basic principle, "Buy where you sell," is easier to understand than free multilateralism. It is obviously imitated from Schacht and Hitler, who in turn revived a mercantilist fallacy centuries old: "The sneaking arts of underling tradesmen," wrote Adam Smith in condemning it, "are thus erected into political maxims for the conduct of a great empire; for it is the most underling tradesmen only who make it a rule to employ chiefly their own customers."

Bilateralism is a necessary part of a "planned," that is to say, a dictated, economy. An internally dictated economy would break down immediately if it permitted free international trade. Internal and external controls necessitate each other. Bilateralism is ideal for

government “planners,” because it permits them to say just how much of this or that shall be sold or bought, and to or from just what country. This enables them to keep their hands on all the strings of business, to retain life and death control over particular industries, and to throw trade this way or that in accordance with the foreign political policy of the moment. But none of this makes for peaceful, free, or stable world trade.

Once we in America have recognized the real nature of the European disease, it should be clear that we have been applying the wrong remedies. Between July 1, 1945, and July 1, 1947, it is estimated, the United States will have contributed abroad nearly \$817,000,000,000 in cash and goods. In general, we have been pouring these gifts and loans into Europe without conditions, or with wholly inadequate conditions. It is not surprising that we have achieved such small results from such huge sums, and that the crisis grows worse instead of better.

The operations of the Export-Import Bank have drifted insensibly from commercial loans to political loans, and then to thinly disguised relief. The managers of the International Fund have next to no power to insist on internal fiscal or economic reforms before they grant their credits. The \$25,000,000 credit recently granted to France, for example, will be used to keep the franc far above its real purchasing power, and at a level which encourages imports and discourages exports. This will merely prolong the unbalance of French trade and create a need for still more loans.

Such a use of the resources of the Fund not only fails to do good but actually does harm. The International Bank has at least the power to refuse loans unless the borrower is “in position to meet its obligations.” But it also lacks clear power to insist on reforms.

It is now contended in Administration and other circles not only that we must make further huge loans to Europe, with equally inadequate conditions, but that there is no use dealing with this matter on a “patch-work, one-at-a-time” basis. We must treat Europe, we are told, on a “Continental plan,” and lend it as a unit one huge sum.

This is much as if a banker were to call all his applicants for loans into a single mass meeting and say: “Listen, it’s just too much trouble to deal with each of you separately, to find out just how much each of you really needs, and whether your individual plans, past record, and present business methods are such as to give reasonable assurance that the money will be properly used and has a good prospect of being repaid. I’ve only got a limited amount of money anyhow, so I’m turning it over to you fellows in a lump and you can divide it among yourselves.”

The real need is the exact opposite of this. Instead of this whole-lump approach, what is needed is a far more careful and critical examination than we have yet been willing to make, of the particular problem of each country and the precise merits of each application for aid. No loan should be granted except in exchange for far-reaching reforms that would really make it possible for the loan to achieve its purpose. Among reforms on which lenders should insist are balanced budgets, a termination of inflationary policies and of exchange controls, and reasonable restoration of external and internal freedom of trade.

After the first world war two types of loans, as W. Randolph Burgess recently pointed out in London, were especially effective—the Central Bank stabilization loans and the League loans. They were effective because each was preceded by a thorough review of the position and program of the borrowing country. The loans were accompanied by expert aid and supervision. The granting of the credit thus became itself an assurance to the world that an effective program had been adopted. Big results were obtained with moderate means.

All this underlines the need of returning the business of international lending as soon as possible to private hands. There could still be an important role for the International Bank while such a shift to private hands was going on. It could stand ready to take the unsold balance of any loan it approved, provided private investors had already subscribed to a certain percentage of it. In this way the Bank would make only loans that had met some test of the market. It would not place itself in the position of imposing conditions, but would merely be a bond buyer.

Certainly it would add to clarity of purpose and better international relations all around if from now on relief were clearly relief, politics were clearly politics, and loans were really loans. ❁

## Why Living Costs Have Risen

June 16, 1947

In recent months there has been increasing concern, as there ought to have been, about rising prices and living costs. And in political discussion the chief blame, as so often in the past, has been placed on the American businessman. Producers and sellers have been asked by the President to hold prices down, as if everything depended solely on their decisions, and as if all they had to decide was whether to hold out for “reasonable” or “unreasonable” profits. But the plain truth is that the rise in living costs has been brought about overwhelmingly



by governmental practices. It is the very people who now point accusatory fingers at the businessman whose policies have done and are doing most to bring about the rise in prices.

The primary cause of the rise in prices has been the mounting volume of money and credit. This has more than tripled since the outbreak of the war. The increase has been mainly the result of the cumulative deficit in the Federal budget financed chiefly by borrowing from the banks. You cannot give people three dollars for every dollar they had before and not expect them to bid up prices. For the rise in the price level must be mainly explained from the side of increased money rather than from the side of shortages of goods. Industrial production in March, in fact, was estimated by the Federal Reserve Board to be running 89 percent higher than in 1935–39. But this was more than offset by income payments 163 percent higher than in 1935–39.

The Administration has certainly made no vigorous attack on this basic cause of higher prices. It continues to spend five times as much money a year as in the immediate prewar period. Through Federal Reserve manipulations it continues to keep interest rates dangerously low. This policy maintains the vast excess of bank deposits and money circulation and encourages further monetization of the public debt.

The government, again, has adopted a consistent policy of promoting wage rate increases. It has done this through Federal laws which take the risks out of striking and make it all but impossible to resist wage-increase demands. It has done it through direct imposition of higher wage rates by so-called “fact-finding boards,” by Presidential intervention, or by property seizure and direct government negotiation of higher wage contracts with unions. As a result of these policies, average weekly manufacturing wages in March, before the latest 15-cent-an-hour increase got started, were 99 percent above the 1939 level and the highest on record. Hourly wages in March, also at the highest point ever reached, were 86 percent above the 1939 level. Wages are normally about eight times as great as profits. To force up wages is to force up prices.

Another major cause of the rise in prices in recent months, which is only now beginning to receive the attention that its real importance warrants, is our national policy of creating a huge export surplus by government gifts and loans to foreign countries. Our exports of goods and services to the rest of the world during 1947 are officially estimated to total \$16,000,000,000, an all-time peacetime high, compared with annual exports of goods and services of only about \$4,000,000,000, before the war.

Against this we are expected to import only about \$8,000,000,000 of goods and services. The export surplus of \$8,000,000,000 a year is inflationary. It means that we are paying out \$8,000,000,000 in wages, salaries, and profits for goods and services that we do not get. It adds \$8,000,000,000 to the excess purchasing power competing for the goods that are left.

Mr. Truman keeps making his drive for “voluntary price reductions” against industrialists. But the great rise in prices has in fact taken place in foodstuffs and farm products. It is on these that the abnormal foreign demand made possible by our gifts and loans has chiefly concentrated. On May 31, on Mr. Truman’s own figures, wholesale prices of farm products were 78.4 percent above the 1926 level. All commodities other than farm products and foods were up only 32.3 percent. All this does not mean we should halt forthwith the gifts and loans to Europe that create our export surplus. We have world responsibilities that we cannot evade. But we must frankly recognize the major inflationary effects of this policy and try to offset it by other means. The government can at least stop artificially supporting prices of farm products. ☸

## Subsidizing Planned Chaos

June 23, 1947

It is unfortunate that Secretary Marshall, in his speech at Harvard, could come so close to diagnosing the real economic disease of Europe and then miss it. He pointed out that “in many countries, confidence in the local currency has been severely shaken.” But he did not tell us why. It is because the governments of these countries have insisted on living beyond their fiscal means; because they have financed the difference by printing more money; and because the ideology and vested political interests within these countries give little assurance that this process can be brought to a halt.

But there is an obstacle to European recovery even more serious. The money, though fallen in value, would still facilitate production and exchange if commodity prices and foreign rates were free to move in response to actual supply and demand. But precisely this is prevented by government controls which make it a crime for anyone to buy or sell goods in accordance with the shrunken value of the currency. The European farmer refuses to plant wheat, or feeds it wastefully to livestock, not, as Secretary Marshall says, because “he cannot find the goods for sale which he desires to purchase,” but because the distortions of price fixing either make it more profitable for him to sell wheat in the form of



poultry, hogs, or beef, or make it unprofitable for him to raise wheat at all. And the principal reason why he cannot get goods in the cities is because price fixing in turn discourages and prevents production and sale in the cities.

Secretary Marshall's speech at Harvard represents an advance in American policy in at least one important respect. It indicates that further financial aid will not be forthcoming from this country except under conditions. But it is extremely vague regarding what these conditions ought to be. There must, said Mr. Marshall, be "some" agreement among the countries of Europe as to the requirements of the situation. Everything depends, however, on precisely what this agreement is. It is not important whether or not some European nations agree to a "joint" program. What is important is whether the programs they adopt, jointly or individually, are really such as to promote economic recovery.

Secretary Marshall's reluctance to suggest a definite program is understandable. He does not wish to put the American Government in the position of "dictating" to Europe or "interfering in its internal affairs." But this is the inescapable dilemma of government lending. For unless the American Government does impose conditions, its future loans, like its past loans, will merely subsidize and prolong the socialistic and restrictive policies that are strangling production and making recovery in Europe impossible.

We now seem ready to make loans to practically any government that says it is anti-Communist, even though the policies it follows mean that the loan will soon be used up, that it will be back for more, that private enterprise in that country is tied hand and foot, and that the borrowing government, in short, though it is "fighting the Communists," is meanwhile pursuing the very economic course that leads toward Communism.

All this suggests that, instead of framing still more grandiose foreign lending schemes, our government ought to get out of the foreign lending business as soon as possible. The best immediate policy is to leave all further foreign loans either to private hands or to the International Bank, which is compelled to take credit-worthiness into account because of the fact that it must sell its debentures to private investors. If the International Bank sends an expert economic mission to each country that applies for a loan, if it frankly tells each borrowing country that investors will not be interested unless that country makes certain specified economic reforms, then a loan may really achieve its purpose. Under such conditions, in fact (as experience with the League of Nations loans proved after the first

world war), it is not the loan itself that is important in assuring recovery, but the reforms made in order to get the loan. ☸

## The New Labor Law

June 30, 1947

It is not surprising that union officialdom should have fought with every weapon in its armory against what it unscrupulously tagged the Taft-Hartley Slave Labor Bill. The new law is not perfect. It retains some mischievous provisions from the old Wagner Act. It includes several provisions which may prove difficult to enforce. But it represents nonetheless an immense step forward. As compared with the last dozen years, the whole climate in which labor negotiations are conducted will now be profoundly improved.

Where the Wagner Act started off with the falsehood that only the transgressions of employers burden or obstruct commerce, the new act from the beginning is two-sided. It declares that *neither* labor nor management has a right to engage in "practices which jeopardize the public health, safety, or interest." The new law defines foremen, and exempts employers from the legal obligation to bargain collectively with them, so clearly that not even the National Labor Relations Board or the Supreme Court majority can "interpret" the provisions away. It makes the general counsel of the new five-man NLRB a direct appointee of the President instead of a creature of the board. This should make the counsel independent and help to separate the board's prosecuting from its judicial functions.

The new law removes the Wagner Act's specific endorsement of the closed shop. It sanctions only the union shop, provided the union itself is "open." It authorizes the checkoff only on the written agreement of each employee affected. For the first time the new law makes it an unfair labor practice not only for an employer, but for a union, to "restrain or coerce" employees in the exercise of their bargaining rights. The new law illegalizes the secondary boycott. It illegalizes "excessive or discriminatory" initiation fees. It restores freedom of speech to the employer when his expression of opinion contains "no threat of reprisal or promise of benefit." The new law makes collective bargaining for the first time a "*mutual* obligation" of employers and unions. The new law makes it clear for the first time that the obligation to bargain "does not compel either party to agree to a proposal or require the making of a concession." The new law holds both parties to a collective bargaining contract. It requires a 60-day notice

on either side before the termination of an existing contract. It deprives any employee who strikes within this 60-day period of his status as an employee under the act unless his employer willingly takes him back. The new act allows an employer as well as a union to petition for a bargaining election. It withholds recognition from unions that refuse to file statements revealing officers' salaries, methods of election, initiation fees and dues, qualifications for membership and grounds for expulsion, and audited financial statements. No union is given protection under the act whose officers refuse to file affidavits that they are not Communists.

Where the old Wagner Act declared that in proceedings before the NLRB "the rules of evidence prevailing in courts of law or equity shall not be controlling," the new act just as specifically requires that such proceedings "shall, so far as practicable, be conducted in accordance with the rules of evidence applicable in the district courts of the United States." Where the Wagner Act held that in court appeals the findings of the NLRB as to the facts should be conclusive "if supported by evidence," the new act insists that they must be "supported by substantial evidence on the record considered as a whole." These two procedural changes alone will make an immense improvement in the fairness with which labor relation cases are tried.

The new law repeats from the Wagner Act the provision that nothing in it shall be construed "so as either to interfere with or impede or diminish in any way the right to strike"; but this time it adds the significant provision "or to affect the limitations or qualifications on that right."

This is by no means a complete list of the important changes. The new law does not guarantee labor peace. No law could. But it provides two-sided bargaining and should improve the whole atmosphere of labor relations. ❁

## Mr. Truman Invited Strikes

July 7, 1947

The series of crippling "protest" strikes which have taken place since the enactment of the new labor law ought to have surprised no one. The union leaders by their hysterical attack on the Taft-Hartley measure as a "slave labor" bill, and the President by the reckless language of his veto, openly invited precisely this result. Mr. Truman repeatedly called the measure "unworkable." He declared that it would "open up opportunities for endless lawsuits." He warned employers that they would "regret the day it was conceived." He predicted

that it would "cause more strikes, not fewer." He repeatedly said that it left unions no means of protecting their rights "except by striking" and "no option but the use of economic force." In the light of this provocative language, Mr. Truman cannot disown responsibility for the strikes that have followed the veto which he must have known would be overridden.

Under the Constitution it is the President's sworn duty to enforce this act in good faith. Yet he can do this now only by doing everything in his power to disprove and discredit his own predictions. It is not realistic to expect this. By his reckless course he has thrown justified suspicion in advance upon every appointment he makes under the new act and every ruling or decision made by his appointees. For the President's veto and warnings will be borne out only if the new law is so administered that it does cause more strikes instead of fewer, if it is so interpreted that it does open up endless lawsuits, and if it really does cause employers to regret the day it was conceived.

It has been suggested that Mr. Truman should recognize his self-created dilemma by asking the whole National Labor Relations Board to resign, and appointing only administrators recommended by the Congressional sponsors of the new labor law. Such a drastic course might solve this particular problem. But the major constitutional dilemma would remain. Mr. Truman's fight a year ago for all-out prolongation of price control, and his veto then of the Case Labor Disputes Bill, were repudiated by the voters in November. It must be said in Mr. Truman's favor that he then interpreted the sweeping verdict of the polls correctly, and appeared to accept it gracefully. He said: "The people have elected a Republican majority to the Senate and House of Representatives. Under our Constitution the Congress is the lawmaking body. The people have chosen to entrust the controlling voice in this branch of the government to the Republican party. I accept this verdict in the spirit in which all good citizens accept the results of any fair election." And Mr. Truman promised to "cooperate in every proper manner" with the new Congress.

Mr. Truman's course in recent months has shown that these fair words meant precisely nothing. For feeble and unconvincing reasons he vetoed a tax-reduction bill that had been passed by heavy majorities in both Houses. This was only the second time in our history that a President had ventured to veto a general tax measure. He then vetoed—but this time unsuccessfully—a major labor bill that had cost Congress five months of work—a bill that he himself described as "perhaps

the most serious economic and social legislation of the past decade.”

Immediately after the political upheaval last November it was suggested, by members of the President's own party and adherents of his policies, that he could create “a notable precedent in American history” by resigning, after allowing Congress to propose a man whom he would name as Secretary of State and who would then constitutionally succeed him. Those who dismissed this suggestion as “silly” could not have stopped to weigh the full consequence of the traditional course. It meant two years of recrimination and deadlock.

The present division and paralysis at the heart of our government makes it next to impossible today for either Congress or the President to frame sound economic policies and put them into effect. This situation darkens the whole economic outlook, domestic and foreign. ❁

## Consequences of Rent Control

July 14, 1947

The President's scolding message on the new rent-control extension law not only implied that Congress should have kept indefinitely almost every wartime control over rents and building, but that no real housing can be built now except by still further government intervention. Yet Congress needlessly left itself open to attack by drafting this rent-control extension with astonishing clumsiness, even from a purely political point of view.

Though Mr. Truman greatly overstated the case against the “voluntary” rent increase of 15 percent, it is subject to legitimate criticism. Nobody wants a rent increase. The individual tenant, therefore, before “agreeing” to such an increase, is really forced to decide what future Federal or state rent-control laws are going to be, how long they will last, and whether his acceptance of a 15 percent increase now will in fact buy sufficient good will from his landlord to assure him a lower rent in the long run. This “voluntary” provision, in other words, forces the individual tenant to gamble on political and psychological factors he cannot measure.

In exempting hotels, again, while keeping rent controls on other residential space, Congress managed to create an exaggerated impression of how much rents in general would rise if all controls were removed. As long as rents in general are legally held below the market level, existing tenants take advantage of this to keep spread out and to use space less economically than otherwise. By increasing the number of people who are

compelled to bid for the uncontrolled space left over, this forces up the market price of such space compared with what it would be if all rents were free.

The biggest political mistake of all, however, was Congress's refusal to provide that any state that wished to do so could at any time take over rent control within its own boundaries. This would not only have saved Congress from a political headache. It was the only Constitutional thing to do. There is not in the Federal constitution a single clause that could plausibly be interpreted to give the Federal government the right to regulate rents in peacetime. If rents are not essentially local, nothing on earth is local. Houses and apartments do not move across state lines. The Federal rent legislation is a symptom of how little anyone any longer cares about states' rights or the limits that our Constitution put on Federal powers.

Mr. Truman in his rent-control message denounced the “brazen operations” of the “real-estate lobby.” The truth is that nowhere in the world does the landlord lobby begin to compare in power with the tenant lobby. Since the outbreak of the war rents have been held down far more than any other major item in the cost of living. In this country, compared with the prewar level, food-stuffs have risen 88 percent, clothing 84 percent, house furnishings 82 percent, all items together 56 percent. Rents have done most to pull this average down. They have risen only 9 percent. We can get some measure of the existing discrimination against the landlord if we ask ourselves what the reception would be to a proposal to treat the landlord as well, or even half as well, as other sellers—to permit him, say, to increase rents by as much, or even half as much, as the average percentage increase that has taken place in all other items in the cost of living.

What is not yet understood is that freeing rents from controls would not in the long run even increase the cost of living. It would merely restore the natural market relationships of prices, rents, and incomes to each other. If people once more had to spend the former proportion of their incomes for rent, they would have just that much less monetary purchasing power left over to bid up the prices of all other things. With rents alone arbitrarily held down, workers whose monthly incomes have more than doubled need spend only half the former percentage of their income for housing. This means that old tenants use space more wastefully, so intensifying the problem of those who happen to have been caught outside. The “housing shortage” is itself in large part a product of the very rent control that “protects” us from it. ❁



## The World's Santa Claus

July 21, 1947

More and more the strange idea is being put forward that America must make loans or gifts to foreign countries, not primarily to save them but to save itself. We are told that we must make these gifts or loans not as a humane or charitable duty but out of shrewd self-interest. Newspaper commentators in the recipient countries have more and more been interpreting our generosity to them on this theory. On June 25 Pravda declared that the Marshall Plan was influenced by a desire to prolong a postwar "boom in the United States" and to "lessen the ripening economic crisis" here.

That Communist Russia should hold such a view is not surprising. It fits in perfectly with all the other claptrap that Communists have long preached about capitalism. But the theory is just as eagerly embraced elsewhere.

A year ago, in its issue of July 12, 1946, the Eastern Economist of New Delhi put it forward in its most candid form. "The United States Lend-Lease plan of helping the Allies in the recent war has been acclaimed as an act of unparalleled generosity," it said. "But it was also a brilliant and ingenious way of solving what would otherwise have been an intractable problem. . . . The productive power of America has multiplied itself so fast that it is now admitted that she cannot continue to give 60,000,000 jobs unless she is able to have a large export trade. . . . In such circumstances it would not be such a foolish thing (as some might imagine) to give away goods to other countries, for on balance it would be better to part with surplus goods than to create unemployment. . . . Machinery should be set up by America whose purpose would be to provide *gifts* of loans to countries. . . . The United States . . . will buy the goods, give them as gifts, and reimburse itself by additional internal taxation. . . . If this is to play the world's Santa Claus, the United States is both rich enough and should have sense enough to fill the role." This idea, in both crude and sophisticated guise, now runs like a refrain through the French and British press.

More surprising, it is endorsed by some American businessmen and even by some American economists. Yet it is unadulterated nonsense.

If we could create prosperity merely by making goods to give away, then we would not have to give them to foreign countries. We could make the goods to give away to our own poor. We could furnish them with free overcoats, free lunches, and free automobiles; build any amount of good new housing, which we badly need, and turn it over to them. Simplest of all, we could

turn over to them direct additional money taken from the taxpayers and let them buy with it whatever they themselves wanted. Why confuse the issue by bringing in foreign nations and foreign trade?

It ought to be clear to the meanest intelligence that nobody can get rich by giving his goods away. What seems to confuse otherwise intelligent people when this proposition is applied to a nation instead of an individual, however, is the fact that particular firms and persons within the nation can profit by such a transaction while the rest of us are forced to absorb the losses. The exporter may profit because he makes additional sales. But if the foreign loan is not repaid, then the loss must be made good out of increased taxes on every American. American consumers will then have just that much less money to buy American goods. Domestic business will lose as much as export business has gained. And the country will be poorer by the amount of goods it has given away.

This would be the consequence of unsound foreign loans at any time. But the country is now in the midst an unprecedented inflationary boom. Precisely when this inflation should be prevented from going further, a government foreign-loan policy can only intensify it. The theory that we need to create an export surplus by unsound governmental loans would be foolish enough even if we had unemployment and wished prices to go up; it becomes downright idiotic in a period of full employment and when everyone is already complaining of high living costs. ❁

## Telling Prices What to Do

July 28, 1947

In 1939, according to the Bureau of Labor Statistics, average weekly wages paid in all manufacturing industries were \$23.86. In bituminous coal mining they were almost exactly the same—\$23.88. In January of this year, weekly wages in all manufacturing industries had advanced 98 percent to \$47.02. In the same period, weekly bituminous coal wages had been boosted 191 percent to \$69.54. These were the highest weekly wages paid in any industry. The cost of living had gone up only 53 percent. The wholesale price of bituminous coal went up in the same period 43 percent.

Such was the situation before John L. Lewis's final triumph a few weeks ago. Then he boosted the hourly wage rates of soft-coal miners from \$1.18½ to \$1.63½. He won \$13.05 for an eight-hour day against \$11.85 for a previous nine-hour day. This means that for the most productive periods the miners' weekly wages were



raised from a former \$69 to \$75 to \$78, depending upon when overtime begins.

All during the period that Mr. Lewis's strike threats were forcing the soft-coal industry to add another rise of about 30 percent in total labor costs, President Truman did nothing. Or rather, he seemed to do everything to strengthen Mr. Lewis's hands. Though the Taft-Hartley bill was finally enacted over his veto, his known opposition made it weaker than it would otherwise have been (particularly in dealing with an industry wide union like the United Mine Workers). By calling it "unworkable" he encouraged unions to flout it or treat it with contempt.

Immediately after the damage was irreparably done, however, the President expressed "deep concern," not about the wage increase itself, but about the possibility of "a substantial increase in the price of coal." This, he feared, would "renew the inflationary spiral." "The people of the country," he went on, "have the right to demand that their prosperity shall not be imperiled by immediate increases in the price of coal and in the price of steel." In other words, he finds nothing to fear when Mr. Lewis or any other labor leader forces any increase whatever in wages. Our economy, it appears, is only "imperiled" when such wage increases are reflected in prices.

Mr. Truman did not stop to tell us what the result would be if this increase were *not* reflected in prices. In 1946 the average net operating profit margin to American mines on a ton of soft coal was 13 cents. The United Mine Workers Journal—which can be counted upon for a low estimate—contends that the cost of soft coal will not be raised more than 65 to 67 cents a ton by the new labor settlement. If the price of soft coal did not go up now, therefore, this would mean an average net operating *loss* to the mines of something in the neighborhood of 52 cents a ton. Would it help the miners, or the steel industry, or production and employment, if the soft-coal mines had to close down because they were losing money?

Do Mr. Truman's advisers know by just how much the coal mines and steel companies should or should not increase the price of coal or steel in order to make just the "right" profit? In view of the heavy losses in the coal or steel industry in bad years, do Mr. Truman's advisers know just how high profits should be in good years to attract both the absolute and relative amounts of new venture capital to assure the right production of steel or coal in relation to other production? Do they know what the profits of industry in general should be to accumulate or attract sufficient new capital to

provide new jobs and bring about a permanent increase in real wages?

Mr. Truman's coal-price statement is even more disturbing to the business outlook than the latest forced boost in coal wages and the distortions in the economy which it will set up, serious as these are. For Mr. Truman's statement is a resumption of the effort to talk down prices by exhortation and veiled warnings. It looks suspiciously like the groundwork of a campaign to restore price control. To encourage a further increase in labor costs while holding down prices would be, of course, the quickest and most certain way to bring prosperity and production to a halt. ❁

## The Midyear Economic Report

August 4, 1947

The President's 82-page Midyear Economic Report, though it contains much instructive material, is clearly intended on the whole as an apologia for the Administration's policies. The "Foreword and Summary" is purely political. The report refers frequently to our "free" economy; yet it tacitly assumes that the government must control everything in this economy and must constantly tell prices and wages what to do. That the government should simply assure an open competitive field, and then let price and wage relationships adjust themselves in a free market, is an idea that never seems to occur to the authors of the report.

There is a great deal of boasting in the report about our "\$225,000,000,000 economy." But there is no reference to the fact that the purchasing power of the dollar in which this "gross national product" is measured is only 55 cents as compared with the dollar of 1935–39. If the gross national product were stated in terms of the prewar price level, it would seem considerably less impressive. The report does not point to the huge increase in money and credit that has been the real cause of the rise in prices. It treats the rise in prices, in fact, as if it were mainly the result of arbitrary decisions by greedy businessmen.

Throughout the report there is an attempt to minimize the rise in wages at the same time that a great deal of alarm is expressed about the past or possible rise in prices. The ordinary reader would hardly suspect from the tone of all this comment (and he is certainly not told) that while compared with the prewar period 1935–39 wholesale prices have increased 83 percent, weekly

manufacturing wages have increased on the average 112 percent. Nor would the ordinary reader suspect, from the studious efforts to minimize the rise in weekly soft-coal wages, that they have gone up twice as much as other industrial wages, and are more than 200 percent above the prewar figure.

While further price rises are deplored throughout the report, we are told that “in some cases wage increases are still needed.” The President recommends an increase of “at least” 62½ percent in the present legal minimum-wage level. He does not say what the effect of this might be in causing unemployment among the very people it is intended to benefit, or in forcing up wages above the minimum to maintain existing differentials. He also wants wages increased that have risen “substantially less than the increase in the cost of living.” But he fails to draw the simple corollary that, unless wages which have increased more than the cost of living are correspondingly reduced, this will simply increase the cost of living still further.

The President’s report opposes “tax reduction now” on the ground that it “would add to inflationary pressures and would also prevent debt reduction.” But it says not a word about accomplishing this by cutting the government’s unparalleled peacetime expenditures. On the contrary, it proposes increased social-security benefit payments, housing subsidies, and government aid to Europe. Whatever the merits of these measures, they must add to inflationary expenditures.

In recent years it has become fashionable to believe that it is the government’s function to “stabilize” the economy and to “compensate” for the mistakes of private business. This belief rests on the assumption, not merely that government officials will always know better than businessmen what to do, but that they will put aside all political considerations and do it.

The President’s report illustrates what happens in real life. A dangerous inflationary boom is being treated as if it were a solid prosperity. Measures like increased social-security payments, housing subsidies, and foreign loans that stimulate exports, which under the “compensated economy” theory would be adopted only in depression, are advocated in a period of unprecedented employment and soaring prices. Further wage advances are encouraged. The net effect of government economic intervention is to push an inflationary boom still farther; for there is always an election ahead, and you must be at the peak of the boom when you get there. ⚙

## A Pro-Labor Law

August 11, 1947

The fate of the Taft-Hartley Act, which goes into effect the 22nd of this month, is an ominous illustration of the power of propaganda. The Wagner Act left the individual worker at the mercy of the union boss. The new law protects the individual worker’s rights and interests. It is precisely because the new law does curb the hitherto unbridled powers of union leaders over the rank and file that these leaders opposed its enactment with every technique of propaganda. They did not shrink from any misrepresentation, however fantastic, including the device of denouncing the measure as a “slave-labor” law.

This was not enough to shake the determination of an overwhelming majority of Congress to pass it. Yet it had its effect, not only on the astonishing language of the President’s veto, but on the rank and file of workers. A recent survey conducted by the Opinion Research Corporation found that 54 percent of the employees questioned, and 64 percent of union members, “disapproved” of the law.

But the survey also uncovered a strange paradox. Notwithstanding their declared disapproval of the new law, a majority of workers favored every individual provision of it on which they were questioned. Even a majority of union members favored every feature of it but one. Here is the result:

Favor law to-	All Employees	Union Members
Require 60-day cooling-off period	78%	70%
Allow companies to sue unions	77%	70%
Allow freedom of speech for employers	69%	61%
Require union financial reports	86%	85%
Prohibit Communist union leaders	76%	77%
Prohibit union political contributions	56%	50%
Allow checkoff only with worker’s consent	68%	74%
Allow union shop only with majority vote	79%	77%
Outlaw closed shop	60%	48%
Delay strikes in public service industries	78%	70%

The new labor law makes it an unfair labor practice for a union as well as an employer to “restrain or coerce” individual workers in the exercise of their bargaining rights. It illegalizes excessive or discriminatory initiation fees. It refuses to certify a union or allow it to bring complaints to the labor board unless it has published a report of its receipts and disbursements, as well as a statement giving its name, the names, titles and salaries of its principal officers, the manner of the election, the initiation fees and dues of the union, a detailed statement of its constitution and bylaws showing the procedure followed regarding qualifications for or restrictions on membership, election of officers, calling of regular or special meetings, levying of assessments, imposition of fines, authorization for strikes, authorization for disbursement of union funds, audit of union financial transactions, expulsion of members and the grounds for it.

Every member of a union will want to know every one of these facts. It is only union bosses who find their arbitrary powers threatened, who want to continue to be highhanded, secretive, and irresponsible to the rank and file of their unions, who have anything to fear from such publicity. It is not surprising when such union bosses announce that they will “bypass” the new law.

Equally important protections for the rank and file are the provision requiring written consent of individual workers for the checkoff of union dues, the provision making it unlawful for an employer to buy off a corrupt or blackmailing union leader, and the provision to assure that so-called “welfare funds” really are used for the union members’ welfare and not merely to make labor leaders financially independent of the rank and file of their unions.

If we are thinking not of retaining unrestricted power for a small union oligarchy, but of the rights of the union rank and file and the rights of the individual workers, then the much abused Taft-Hartley Act far more deserves the title of a pro-labor law than the misconceived Wagner Act ever did. ⚙

## The Myth of a Dollar Famine

August 18, 1947

Mr. Dalton’s defenders claim that he was unaware of the fact that not only Britain but Canada, Argentina, Spain, and other countries also were suffering from serious dollar shortages....The [British] Government defense is that the whole world is in the grip of a dollar famine that is rapidly becoming so severe that it

will produce deflation and unemployment everywhere unless the United States acts quickly to relieve it.”

These sentences from a London dispatch to The New York Times give an accurate reflection, not merely of the views of the British, but of outside nations in general. Their plight, as they see it, is not their fault, but ours. It is not Britain or Europe, but the United States, that must “act quickly.” It is we who must contribute still more loans or gifts to make up whatever deficit in its trade balance the outside world succeeds in bringing about.

It is of the first importance, if the world is to apply correct remedies for the present crisis, that it separate the sense from the nonsense in these allegation of a world dollar famine. In one sense, of course, Britain (or France, or Mexico, or the Argentine) is correct in attributing its troubles to a “dollar shortage.” In the same sense, an American would be correct in saying that the reason he could not pay his grocery bill or buy himself a new car is that he was suffering from a dollar shortage. But such a description does not explain anything. The real question we must answer, either for the foreign nation or the individual citizen, is what causes the dollar shortage.

Now for Britain or Europe or Latin America to describe its plight as a “dollar shortage” is really a way of implying that the situation is somehow our fault. We are being blamed for not supplying enough dollars. The real trouble, however, is that Britain and Europe and Latin America wish to buy more from the United States than they sell to it. They wish to get from us more than they give. They wish to buy more than they can afford to pay for. They are consuming more than they are producing. The only permanent remedy is for them to increase their production or reduce their consumption. As long as they do neither they can only keep up the one-sided trade with us with the proceeds of our loans or gifts. We are in fact supplying the outside world with \$1,000,000,000 worth of goods and services every month in excess of what we get in return.

In brief, the trouble at bottom is not a shortage of dollars but a shortage of goods and services to exchange for dollars. To talk of a shortage of dollars in any absolute sense is absurd. In the last two years the United States has contributed to the outside world cash and goods estimated at nearly \$17,000,000,000. The gold and dollars now held by the outside world are estimated to reach the unprecedented total of more than \$20,000,000,000. Why, in the face of this, does Europe complain more loudly than ever of a “dollar famine”? Why has the world’s trade become so unbalanced? The whole answer would be complex; but the



chief responsibility must be placed upon government controls. Most of the governments of the world today, by forcing commodity prices below the levels that supply and demand would bring about, are creating artificial bottlenecks and shortages. When they draw on us for the deficiency, they cause shortages and higher prices even here.

But the gravest case of arbitrary price fixing is the overvaluation that nearly all countries place on their own currencies. They will not accept the verdict of the open market as to what those currencies are really worth. They will not even allow that open market to operate. By keeping their currencies artificially high, they make imports from America relatively cheap in terms of their own currencies at the same time that they make the prices of their exports prohibitively high in terms of dollars. It is this that is chiefly causing the chronic unbalance of trade.

What the world is suffering from today is not a dollar crisis. It is a sterling crisis, a franc crisis, a guilder crisis, a peso crisis. It staggers from crisis to crisis because it will not allow free markets to function. ⚙

## The Bankruptcy of 'Planning'

August 25, 1947

The British press regarded the recent economic proposals of Prime Minister Attlee as "inadequate" and "vague." The Opposition called them "totalitarian." But very few pointed out that, wholly apart from their effect on human liberties, the economic remedies put forward by the Prime Minister were precisely the opposite of those that the situation called for.

The fundamental trouble with the British economy today is governmental "planning" itself. The British Government has refused to let the free market work. And when the policy of government restriction breaks down, Mr. Attlee, far from recognizing that the past restrictions have brought about the present collapse, opines that "as things have turned out, we have perhaps moved too far and too fast" in the direction of restoring "freedom of individuals to undertake the kind of work that they prefer."

Mr. Attlee thinks the trouble with England is "a world shortage of dollars." The mistaken nature of this complaint was pointed out in this column last week. He is equally mistaken in complaining of the provisions in the American loan agreement for sterling convertibility and for non-discrimination against American goods. Both these provisions were sound in themselves. It is chiefly because of its own economic controls,

particularly over sterling, that it has been difficult for the British Government to fulfill these provisions.

"Definite targets," declares the Prime Minister reassuringly, "are being set for basic industries." But definite targets were set long ago, and were simply not achieved. Mr. Attlee seems to think that if the targets previously set proved too high for achievement, the remedy is to set still higher targets. "For the year 1948, we must raise our sights." But this is merely planning by exhortation and rhetoric; it is wish-planning. A nation cannot simply talk itself into higher production. Nor is it the function of government statisticians to decide precisely how great coal production, steel production, or particular exports ought to be. Neither government statisticians nor anyone else can know in advance precisely what steel production ought to be in relation to coal production, or the export of one commodity in relation to another. On the contrary, it is the function of individual consumers and producers, buyers and sellers, to establish the absolute and relative production of thousands of different commodities and services by expressing their decisions through a free market.

"We need," declares Mr. Attlee, "faith in freedom." Noble words. But in Mr. Attlee's economic policy there is no faith in economic freedom, in freedom of the market, freedom of the consumer, or even in freedom for labor. Sir Stafford Cripps declared in the House of Commons on Feb. 26, 1946: "No country in the world, so far as I know, has yet succeeded in carrying through a planned economy without compulsion of labor. Our objective is to carry through a planned economy without compulsion of labor."

But only eighteen months later Mr. Attlee is already admitting that his new program "will involve some sacrifice of individual liberty—by both employers and workers. . . . We shall have to take some measure of control over the employment of labor."

In announcing his new plans Mr. Attlee repeatedly called for more "sacrifices" from the British public. But as Prof. John Jewkes of the University of Manchester pointed out last January: "Any plan which calls for 'sacrifices' should be subject to suspicion, since the purpose of a plan (except perhaps in case of war or threatened war) should be to lessen sacrifices and not increase them."

Fanatics have been defined by Santayana as people who redouble their efforts after they have forgotten their aim. So the heads of the Labor government are forgetting their ideals of liberty, forgetting even the material purpose of their plan, and drive grimly ahead with a plan that has become an end in itself. Meanwhile their planned economy is running out of coal, running



out of food, running out of dollars. And perhaps most serious of all, it is running out of alibis. ☸

## A Modern Corporation Reports

September 1, 1947

To our Stockholders:

Your corporation has always sought to be up-to-date, and to act in accordance with the precepts of the most forward-looking economists and statesmen. Your corporation seeks only service, and not profits. We are happy to report that in the last calendar year we have been of infinite service and have made no profits whatever.

Your corporation has of course kept in mind the importance of constantly boosting wages. Our workers must be paid enough to buy back the product we make, which consists mainly of nuts and bolts. We also wish to boost wages to increase the national purchasing power. In accordance with our understanding of the objectives of the CIO, we last year granted our workers an increase of 15 percent every month over the preceding month.

In January we made the mistake of announcing our first 15 percent increase without consulting the union leaders. We were promptly notified by the National Labor Relations Board that we had been guilty of an unfair labor practice in not having engaged in collective bargaining. We rectified this mistake in February. In our March negotiations, however, the union leaders called our attention to the fact that these voluntary raises on our part were undermining their position with the rank and file, who were beginning to ask whether they needed any high-salaried union leaders at all. The union leaders therefore suggested that the 15 percent increase ought to be granted every month only after they had demanded 30 percent, so that the wage increases each month could appear to be wrung from us. We agreed to this arrangement as the only one under which collective bargaining and a strong union organization could be preserved.

In accordance with the demands for "full employment" we have naturally sought every means by which to make more work. For this purpose we have hired inefficiency experts and specialists in unscientific management who are able through motion analysis to find slower and more complicated ways of doing things and who call attention to points at which labor-saving machinery can be got rid of. Through their expert

services we are proud to announce that we succeeded in raising employment 37.2 percent last year with no increase in output whatever.

We have paid special attention to expanding our export sales by granting credits to foreign customers. Our company economist has pointed out to us that it is of no importance whether or not these loans are ever repaid, because they enormously increase our export sales. Moreover, he points out that it will be of particular advantage to the country if the loans are never repaid at all, because in return for our exports there will then be no imports to threaten our home industries.

Your corporation has issued a volume of bonds during the year which greatly exceeds the value of the corporation's assets. We consider our bondholders, however, part of our corporate family. There is nothing to worry about, because as one big family we merely owe this debt to ourselves.

Your corporation has also contributed outstandingly to the fight against inflation. In accordance with the President's request, we have constantly reduced our prices. As they are now far below production costs we feel confident that they must be fair. It is in the realm of prices, in fact, that your corporation has made a great contribution not only to prosperity but to economic science. Our company economist has long pointed out to us that if we constantly reduce prices we will constantly increase our volume of sales. We have found this to be so. We have finally found, in fact, that we dispose of the greatest volume of goods when we charge no price for them at all.

In this shining record of achievement, your corporation must report only one fly in the ointment. This, we regret to announce, is our last report. We are bankrupt and going out of business today.

Signed,  
I. M. N. ADDLEPATE,  
President

## The Fund vs. World Recovery

September 8, 1947

The greatest single barrier to world recovery (if we exclude for the moment Russia and Communism) is hardly being discussed at all. This is the use of government police power to keep the price of currencies far above their real market value. It is failure to recognize the consequence of this policy that has made the whole

discussion of the Marshall Plan, and of Great Britain's trade and dollar difficulties, so unreal.

Suppose, for example, that a French brandy sells in Paris for 1,200 francs a bottle. The black-market rate for the franc is about 280 to the dollar. Let us assume that in a free market it would be about 240 to the dollar. At such a rate the brandy could be bought for \$5 a bottle in American money. But the official rate for the French franc, which the American importer is now forced to pay, is about 120 to the dollar. This means that the brandy must cost him \$10 a bottle. The arbitrary exchange rate raises the price as much as would a 100 percent import duty (on top of the duty that we actually impose). And this applies to every French import to this country.

Is it surprising, apart from any other factor, that France is exporting so relatively little to us?

In the same way, if we look at the problem from the other side, a typewriter that costs \$100 in the United States would cost a French buyer, if he had to pay 240 francs for the dollar, 24,000 francs. But as he is able, thanks to exchange control and American loans, to get the dollar for only 120 francs, the typewriter costs him only 12,000 francs. And this applies to every American import to France. Is it surprising that Frenchmen would want to buy a great deal from us?

Yet nearly every currency in the world (with a few exceptions like the Swiss franc) is overvalued in terms of the dollar. It is precisely this overvaluation which brings about the so-called dollar scarcity. For it not only encourages other countries to increase their buying from us at the same time as it discourages our buying from them, but it leads to a demand for the dollar as a direct investment because it can be bought at bargain prices. This is the situation which the British encountered when they made the pound for a short time freely convertible into dollars. Nearly everybody who had the right to get dollars asked for them—not necessarily because he wanted American goods instead of British goods, but because pounds were worth less and dollars more than the official rate of exchange between them.

This situation would long ago have corrected itself if it had been left free to do so. When Europe's imports exceeded its exports, the demand for dollars would have raised the price of dollars in European currencies. This would have made American goods more expensive for European buyers at the same time as it made European goods cheaper for Americans. The balance of trade would have been automatically restored.

Moreover, if importers and exporters were free to buy and sell exchange at the rates that supply and

demand warranted, all currencies would be freely convertible at a price. Britain, for example, could convert its "soft" into "hard" currencies at will at prevailing market rates. It is only because people are not allowed to pay or ask the real market rates that the conversion does not take place.

Why is this simple solution to the dollar and foreign-trade problem not adopted? Because under the Bretton Woods agreements (Article IV, Sections 3 and 4) each member of the International Monetary Fund is not merely permitted but compelled to forbid currency transactions within its own borders at other than the official rates. There can be no solution of the world unbalance of trade and of the so-called "world dollar famine" until this provision is revised to permit the restoration of free world markets in foreign exchange. Not until such free world markets exist can we tell what the real "needs" of Europe are. We might find, indeed, that the restoration of free markets in exchange, especially if combined with the restoration of free markets in commodities, would make the whole "Marshall Plan" unnecessary. ☼

## Why Not Also Capital Day?

September 15, 1947

Union politicians chose the Labor Day week end this year to let loose a Niagara of nonsense. William Green, president of the AFL, denounced the Taft-Hartley Act as "the most oppressive. . . the most offensive and most reprehensible law ever enacted against the nation's workers." He neglected to submit a bill of particulars. Is the worker oppressed by the provision making it an unfair labor practice for a union as well as an employer to "restrain or coerce" him in the exercise of his bargaining rights? Is he oppressed by the provision requiring his written consent for a check-off of union dues? Or by the ban on excessive initiation fees? Or by the requirement that the union officials disclose how their union is run? Or is it perhaps merely the union bosses who resent these curbs?

"We believe industrial peace can be promoted." continued Mr. Green, "through . . . collective bargaining contracts . . . which we hold sacred and inviolate." Then why object to the Taft-Hartley provisions holding unions as well as employers legally responsible for living up to these contracts?

Philip Murray, president of the CIO, competed with Mr. Green in lashing out against the "infamous" Taft-Hartley Act. Mr. Murray is worried about the way

workers are being “squeezed economically” by higher living costs and “smaller and smaller purchasing power,” He wants to restore price control. That price control always reduces and distorts production, and that in the long run it cannot be made to work at all without wage control, are among the little details about which Mr. Murray never bothers his pretty head. But it is about time someone told him the elementary facts about “shrinking purchasing power” and the “economic squeeze.” The figures of the Department of Commerce show that purchasing power in this country is higher than any levels ever reached before in our history. And the figures of the Department of Labor reveal that while living costs had risen by June of this year 57 percent since 1935–39, average weekly wages in manufacturing industries had risen in the same period by 120 percent. Whoever is being “squeezed” compared with his pre-war status, it is not the average American factory worker.

President Truman also made his Labor Day statement. “Good labor relations,” he decided, “cannot be brought about by legislation.” He called for a “minimum amount of regulatory law.” This was strikingly similar to Mr. Murray’s statement that management and labor can settle their problems “without need of coercion, force, and legislation.” But this seems a rather belated discovery. Neither Mr. Murray nor Mr. Truman objected to “legislation” when it was directed solely against the employer. Only when the Taft-Hartley Act made some attempt to place upon unions duties and responsibilities commensurate with their expanded legal rights and privileges did this outcry against “legislation” come from the self-styled “pro-labor” ranks.

And one wonders about the consistency and sincerity of this outcry against “legislation” when it is accomplished by a plea by the labor leaders and the President for a further increase in minimum wage rates—in other words, for still more legislation, for a further substitution of government coercion for competition or collective bargaining. The simple truth is that nothing would jolt union leadership in this country more than a simple repeal of the [Wagner Act]. What union officialdom really wants is to restore the one-sided Wagner Act and turn the government once again into a union-organizing agency.

These criticisms should end on a constructive note. Why not set aside the Monday following Labor Day as Capital Day? Why not devote at least one day to pointing out the importance of profits as a means of guiding output and encouraging capital accumulation and investment, and to emphasizing the importance of investment for providing new jobs, increasing

production and raising wages? Labor Day reminds us that capital depends on labor. Capital Day could remind us that labor depends no less on capital. ☼

## Lenin Was Right

September 22, 1947

Lenin is said to have declared that the best way to destroy the capitalist system was to debauch the currency. Lenin was certainly right. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.

In the latter stages of the war all the belligerent governments practiced, from necessity or incompetence, what a Bolshevik might have done from design. Even now, when the war is over, most of them continue out of weakness the same malpractices. But further, the governments of Europe, being many of them at this moment reckless in their methods as well as weak, seek to direct on to a class known as “profiteers” the popular indignation against the more obvious consequences of their vicious methods.

These “profiteers” are, broadly speaking, the entrepreneur class of capitalists, that is to say, the active and constructive element in the whole capitalist society, who in a period of rapidly rising prices cannot help but get rich quick whether they wish it or desire it or not. If prices are continually rising, every trader who has purchased for stock or owns property and plant inevitably makes profits. By directing hatred against this class, therefore, the European governments are carrying a step further the fatal process which the subtle mind of Lenin had consciously conceived. The profiteers are a consequence and not a cause of rising prices.

This column up to this point should have been in quotation marks, with a few dots to indicate omissions. The foregoing are not my words, but the words of John Maynard Keynes. They appeared 27 years ago in “The Economic Consequences of the Peace.” If they do not apply with uncanny accuracy to conditions now, it is only because conditions now are worse. European governments today, far from resting content with denunciations of “profiteering,” decree that regardless of how much they have debased their currencies, prices in terms of those currencies must not rise. The result of this direct meddling with the market mechanism has been to distort and prevent production. And to bring on a world crisis.

This is intensified by price control of the paper currencies themselves. It has been made a crime for



exporters or importers to buy or sell those paper currencies for less than their “official” rates in terms of other currencies. This has led to a violent unbalance of foreign trade and prevented all the normal processes of self-adjustment from taking place. The European governments are united, however, in describing their trouble as a “dollar shortage,” thus implying that it can only be cured by further huge loans from America.

Our own government accepts this “dollar shortage” explanation. Yet there are more dollars outstanding today than ever before. Between June of 1939 and June of this year, total demand deposits and currency outside banks increased from \$33,360,000,000 to \$108,500,000,000. This huge outpouring of dollars is the basic cause of the rise in prices in that period. There is more than three times as much money as before bidding for the existing American goods. We too, in short, have debauched our currency.

This is carried further when, with the help of government loans abroad, we ship to foreign countries \$12,000,000,000 a year in goods and services in excess of those we receive. The \$12,000,000,000 we distribute in wages, salaries, and profits in turning out these excess exports are an addition to monetary purchasing power not offset by an addition to American goods. On top of the basic increase in monetary purchasing power, these excess exports have been the main cause of the recent additional increase in prices.

But government officials, instead of recognizing this inflation as the result of their own policies, blame the business class. They start “monopoly” investigations and prosecutions which are thinly disguised attempts to put the blame for the price increase on business and to reimpose backdoor price control through intimidation. Labor leaders like Walter Reuther demand reimposition of price controls.

Lenin was certainly right. ☸

## The Profiteer Hunt Is On

September 29, 1947

The basic causes for high prices in this country have been frequently rehearsed in this column. The volume of money and bank deposits competing for goods is now more than three times as great as in 1939. This has been reflected in money incomes. Total pay to employees increased from \$47,800,000,000 in 1939 to an annual rate of \$125,300,000,000 in the first half of this year. Expenditures on personal consumption of all classes increased from \$67,500,000,000 in 1939 to a rate of \$158,000,000,000 this year. Inevitably this has been

reflected in an increased demand for food. In spite of the price rise, the per capita consumption of meat in this country, which was 132 pounds in 1939, is now running at an annual rate of about 155 pounds.

On top of this basic increase in domestic monetary purchasing power have been the shortages in Europe. European demand has been greatly increased by American Government aid which has supplied Europe with additional dollar purchasing power to compete for our goods. This has drained away part of those goods, particularly foodstuffs, and so raised prices further.

These, and prospective new loans under the Marshall Plan, have been the real major causes of the price rise. But politicians and professional business-baiters are ignoring them in a shrill hunt for personal scapegoats. First come “the speculators.” The drive against speculation is reflected in the demand of the Federal government that the nation’s principal grain exchanges double their margin requirements. This strikes merely at a symptom. Speculation is an inherent part of the process of production. Whether a prospector is sinking an oil well, or a department-store buyer is guessing what women’s skirt lengths will be a few months from now, or a miller has contracted for wheat, there is a speculative risk involved. Someone has to assume it. In the grain, cotton, and other markets there has grown up a class of professional speculators willing and eager to assume these risks, so that processors are relieved of them.

The speculator can make money only if he guesses right on future prices. If he guesses wrong he loses. He is popularly supposed to be wicked when he buys grain and holds it off the market in the hope of higher prices. But if his judgment is right, he performs a public service: he conserves supplies to sell at a time of greater scarcity than when he bought. To the extent that the speculator is right he stabilizes prices. Another set of scapegoats now being hunted out by the politicians are the “profiteers.” This is reflected in the drive of the Department of Justice against those perennial scapegoats, the meat packers. Now it happens, if facts matter, that the profit margin on sales of seventeen principal companies in the meat-packing industry in 1946 was only 1.7 percent, compared with an average of 6 percent for industrial companies in general. The “profiteering” drive has turned as well against retail butchers and grocers. Yet even if we assume for the sake of argument that nearly everybody in the business of supplying the world with food is greedy for profits, the assumption does not tell us why such greedy people were not charging just as high prices nine months ago or nine years ago.



The rise in prices has been followed by the inevitable demands from the uninformed for a return to price-fixing. The reimposition of price-fixing in the United States would be particularly ironic. European price-fixing has been one of the major causes of the shortages in Europe.

The rest of the world has turned to the one great remaining free-enterprise country to make up the scarcities that its socialism and “planning” have brought about. This has naturally sent prices here soaring. If now we too reduce prices by decree, we in turn will reduce or remove the incentives to produce.

The one thing that government interventionists cannot learn is that wherever exceptional shortages exist we need exceptional profits to give exceptional incentives to production. The chief effect of the mania for government meddling all over the world has been to prevent free markets from balancing and increasing production. ❁

## How Much Does Europe Need?

October 6, 1947

The sixteen European nations reporting on the Marshall Plan calculate their needs for outside help over the next four years at more than \$25,000,000,000. Of this some \$19,000,000,000 is presumably expected to come direct from the United States Government, some \$3,000,000,000 from the International Bank, for financing equipment, and some \$3,000,000,000 for currency stabilization loans (presumably—though this is not made clear in the report—from the International Fund). The chief contributor both to the Bank and the Fund is, of course, also the United States Government.

Here is a staggering bill. And when we put it on top of some \$15,000,000,000 that the United States will have spent by the end of the present year in rebuilding Europe since V-J Day, it brings the total to around \$40,000,000,000.

How much validity do the “deficit” figures presented by Europe really have? The original total that the sixteen nations arrived at, we must remember, amounted to more than \$29,000,000,000—apparently not including the \$3,000,000,000 estimate for currency stabilization. Not until after our State Department privately protested that this sum was too large was it reduced to \$22,440,000,000 (with \$3,130,000,000 of it assigned to the International Bank). The estimate now published presumably meets our State Department’s demands, in that it is lower than the original estimate, and tapers down each year. But suppose our government does all

that is now demanded of it, and the scheme still breaks down? Will we not be told that it was our fault—that our aid was “too little and too late”—that these were not Europe’s real estimates of its needs, but merely slashed figures put forward to conciliate the State Department and an “economy-minded” Congress?

Even apart from this, what reason is there to take seriously these estimates of annual deficits? The report itself declares: “Unfortunately, the size of the problem has proved greater than was expected. The disruption caused by the war was more far-reaching and the obstacles to recovery more formidable than was realized even six months ago.” But if the sixteen nations admit that they then failed to guess right even six months ahead, what reason is there to suppose that they are now guessing right four years ahead? And if (as we must suspect) the deterioration in the last six months has not been the result of a war that ended more than two years ago but of new factors, and primarily of the unsound economic policies followed by European governments themselves in these last six months, then the prospective European “deficit” could be either much greater or much less than the figures presented, depending upon the future policies followed.

It is impossible, in fact, for any nation to predict its future trade deficit by adding together its future “requirements” of specific goods. For such “requirements” are arbitrary except in relation to some standard, and the standard adopted must itself be arbitrary. There is, moreover, no such thing as a predestined trade deficit independent of loans from outside, of internal inflation, of price fixing, of tariff policies, of trade controls, of domestic production, and of foreign-exchange rates.

One of the most serious factors in bringing about Europe’s recent chronic trade deficit has been overvalued currencies and pegged exchange rates which encourage imports and discourage exports. The unpegging of exchange rates might reverse the trade balance of many European countries almost overnight. Yet there is no indication that a free market will be restored in foreign exchange or, for that matter, in anything else. On the contrary, the report assumes that government economic controls will be tighter than ever. Ambitious production and export “targets” are fixed by the sixteen governments. Is there any reason to suppose that these are more likely to be attained than previous targets which are now consigned to oblivion? The report indicates that Europe will continue in the main to rely on the very controls that have prevented postwar recovery so far. ❁

## Europe's Four-Year Plan

October 13, 1947

The report of sixteen European nations in response to the Marshall Plan is a skillful presentation of the case for heavy and immediate financial aid from America. But the more the report is examined the less assurance does it give that these nations are even yet prepared to abandon the economic restrictions that have been chiefly responsible for bringing on the present crisis.

Throughout the report there is constant emphasis on production "targets." We are told precisely how much bread grains, potatoes, sugar, meat and milk these countries intend to produce in each of the next four years; precisely how many tons of coal and steel, and how many kilowatt hours of electricity; precisely how much they intend to expand oil-refining capacity, inland transport and merchant fleets. We are proudly told that "these production programs, taken as a whole, represent an expansion of output similar in general scale to that achieved by the United States in the mobilization years 1940-44." There seems to be an implication here that to set a target is almost as good as to reach it. Surely the fate of the British targets adopted so confidently nine months ago ought to have sufficiently underlined the difference between ardent hopes and cold realities.

The whole concept of government "production targets" is in origin totalitarian. It is part of the modern mania for imitating Russian Five-Year plans—an imitation that is the sincerest flattery to Communism. Why should the Russian Communists doubt the superiority of their system when they see nearly all of Europe aping one of its basic features? For only under a collectivist concept is it considered the function of government officials to say just how much shall be produced of each major commodity. It is of minor importance that the guesses of the bureaucrats are almost bound to go wrong. Far more serious is the fact that the mere setting of government production targets is in effect a way of setting aside the free market, setting aside a free economy. It is a way of telling the consumers that the things that are produced, and the relative proportions they are produced in, are not to be determined by their own demands but by what government bureaucrats decide in advance is good for them.

The supreme irony is that the only country in the world today that is really producing anything—and for whose goods the rest of the world is therefore clamoring—is almost the only country that does not have government production "targets," but merely turns out goods in the volumes and proportions determined by supply and demand, free prices and free profits. But just

as the rooster Chanticleer was convinced that the sun could not rise until he crowed, so European bureaucrats are still convinced that there can be no production unless they first of all set production targets.

Implicit in production "targets" is the whole system of price control, rationing, allocations, government licenses, prohibitions, and decrees. There is no indication in the sixteen-nation report that this dictated economic system is to be abandoned, certainly not in the near future. Only once in the report is it admitted that the system of price control "is likely to jeopardize production." But this delicate hint is not elaborated, nor is any conclusion deduced from it. Under present circumstances, the report assumes, "stability cannot exist unless it is constantly reinforced by controls and rationing."

In short, European bureaucracy still believes what our OPA believed, that price control cannot be abandoned "until supply catches up with demand." What this overlooks is that artificially low price ceilings increase demand and reduce production and supply, so perpetuating the shortage they were designed to counter. In the European system almost the whole mechanism of economic self-adjustment has been destroyed. Neither prices nor wages nor exchange rates are free to move to the points where they can tell the truth about ever-changing relations of supply and demand and restore equilibrium between them. The result is a chronic shortage of goods and a trade deficit. ☸

## The Drive against 'Gambling'

October 20, 1947

President Truman had no legal power to order the nation's grain exchanges to increase their margin requirements to 33⅓ percent. But he forced them to do so by threatening to exercise the legal powers he and the Commodity Exchange Authority did have to do something else. This is a technique of executive usurpation which deserves the careful attention of Congress. The purpose of the present column is merely to examine the economics of the Administration's action. Its chief effect, like that of the 75 percent margin insisted on by the Federal Reserve Board for stocks, will not be to lower prices, but merely to make the market narrower and day-to-day fluctuations more erratic than otherwise.

When crop shortages or the government's own monetary or other policies have brought about high prices for food, it has been the technique of governments from time immemorial to blame the result on

“speculators” and “gamblers.” What we are dealing with here, therefore, is not something that has merely happened within the last few weeks, but something that happens repeatedly. Let us, therefore, call in some expert witnesses from the past.

“Hasty attempts to control speculation by simple enactments have invariably proved either futile or mischievous.”—Alfred Marshall, in 1890.

“The result of regular speculation is to steady prices . . . A good example of this is afforded by the Gold Law during the Civil War. The discount on greenbacks was mistakenly ascribed to the speculation on the gold exchange, and a law was enacted to prohibit all such transactions. As a result, the premium on gold jumped at once from 195 to 285, with wild fluctuations day by day, to be followed, after the hasty repeal of the law fifteen days later, by just as sudden a recession of the price.”—E. R. A. Seligman, in 1905.

“Speculation . . . tends to make daily market prices conform to the seasonal market price. . . . The general effect of speculation is to lessen fluctuations. . . . For the ultimate consumers, say of wheat, the early and exact adjustment of price brings more even utilization of the available supply. If the crop is short, some lessening of consumption is inevitable; and it is better that the deficit be spread through the season. The sooner and the more exactly the higher price is reached, the more likely is this result.”—F. W. Taussig, in 1911.

“[Blaming speculators] is the recourse of governments in search of a scapegoat. . . . Price fluctuations are reduced by speculation, not aggravated, as the popular legend has it.”—Ludwig von Mises, in 1924.

While Washington is now pointing toward “gambling in grain” in Chicago, Kansas City and Minneapolis as a cause of high food prices, its own direct responsibility might be profitably considered. Passing over its inflationary policy in general, the government is committed to lend the farmer 90 percent of parity on his wheat. At the present time this comes to \$2.08 a bushel at Chicago. The result of this, as already pointed out by Edward H. Collins in *The New York Times* (Oct. 6), is that the trader “has a speculation in which his loss is limited, on the downside, by the policy of the government itself, to about 67 cents a bushel. On the upside, by contrast, the ceiling is ‘infinity.’ Can there be any reasonable doubt that this constitutes an open and shut invitation to violent speculation on the long side?”

One more contemporary witness. “Under the law the government supported prices of potatoes—the best possible replacement for cereal foods—last year and

this. Most of the potatoes it acquired last year were diverted to non-food uses, wasted, or destroyed. . . . The Department of Agriculture this year reduced potato acreage goals and stipulated that support would be given only to producers who complied with lower goals. As a result harvested acreage this year will be about 15 percent smaller and the potato crop in prospect is below normal consumption requirements. The potato policy therefore has turned out to be a mistake of the first magnitude.”—National City Bank of New York October Letter. ❁

## Are Profits Too High?

October 27, 1947

Corporate profits in terms of dollars are now running at the highest levels on record. In 1946 they amounted after taxes to \$12,539,000,000. In the first six months of this year, according to estimates of the United States Department of Commerce, corporate profits after taxes were running at an annual rate of \$17,000,000,000, an increase over the 1946 rate of about 35 percent.

Such figures are often cited today as a sort of economic scandal. They are taken as *prima facie* evidence that current profits are outrageous, that they bear an unhealthy relation to wages, and that prices could be substantially reduced without harm. The dimensions of these profits begin to evaporate, however, when we examine them more closely and in their broader context.

1—While corporate profits in recent years have been running at record levels, so have wages and the national income. Dollars themselves, in fact, are so plentiful that they have become cheap. As compared with its 1935–39 wholesale purchasing power, the dollar today is worth only 54 cents.

2—Corporate profits are greatly overstated today even in terms of depreciated dollars because proper deductions are not being made. The market price of a firm’s inventories may have doubled. The dollar increase in inventory value is set down as a profit. But when the firm comes to replace its inventories, as it must, it needs twice as much money to replace the same physical supply as it had before. If it restored only its original dollar investment in inventories, it could do only half its former volume of business. The Department of Commerce in its revised national income statistics published in July takes account of this factor, and



deducts from the \$12,500,000,000 figure of 1946 corporate profits \$4,700,000,000 as an “inventory valuation adjustment.”

The National Industrial Conference Board has pointed out that when these inventory profits are deducted, the net earnings of corporations after taxes in 1946 constituted only 4.6 percent of the national income (less corporate income and excess-profits taxes)—a smaller percentage than in any year since 1935. Even during the first half of 1947 corporate profits, when similarly reduced and treated as a percentage of the national income, were appreciably below 1940 and 1937.

3—Practically all deductions for depreciation are inadequate today. A worn-out or obsolete machine that cost \$10,000 ten years ago may cost to replace not \$10,000 but \$15,000 or \$20,000. The tax laws, however, permit only depreciation charges based on original cost, not on higher replacement cost. As a consequence, the Machinery and Allied Products Institute concludes that industry is understating the costs arising from the consumption of its fixed assets, overstating its profits, and in some cases perhaps underpricing its products. In short, there is going on an erosion of real capital not offset by depreciation charges. Economists have estimated that a true corporate depreciation allowance in 1946 may have run from \$1,500,000,000 to \$5,000,000,000 higher than the allowance actually made.

4—Present corporate profits are the result of unprecedented volume of business rather than of wide profit margins. The combined net income of 24 leading companies in wholesale and retail trade, for example, averaged 2.6 cents per dollar of sales in the first half of 1947, against 3.3 cents in the second half of 1946 and 3.9 cents in the first half. So-called corporate “break-even points” are today much higher than before the war, and wage costs are far more resistant to downward adjustment. A comparatively small reduction in output or volume of sales, therefore, could mean for many companies today a very sharp reduction or even a disappearance of profits.

5—Corporate profits can be added together for special statistical purposes, but it is misleading ever to discuss them as if they formed a common pool. A high total of corporate profits is no help to an individual company with a deficit. Even major group divisions emphasize this fact. The country’s railways, for example, on present methods of accounting, earned an average of only 2.75 percent on their property investment in 1946. ❁

## The Dilemma of the Marshall Plan

November 3, 1947

The proponents of the Marshall Plan are right in believing that Europe is in the grip of an economic crisis. They are right in believing that our own economic and political future will be deeply affected by the fate of Europe. They are right in urging that we should do anything we can that promises to increase Europe’s welfare without imperiling our own.

But the proponents of the Marshall Plan mistakenly assume that the crisis in which Europe finds itself today is primarily the result of the destruction and dislocations of the war. They have yet to recognize that, on the contrary, this crisis is for the most part self-imposed. It is primarily the result of the economic policies that have been followed since V-E Day by the governments of Europe.

Europe is caught today in a strangling network of governmental controls. These controls include the pegging of foreign-exchange rates far above their real values. This encourages imports and discourages exports, causes a chronic deficit in Europe’s trade balance, and brings about a so-called “dollar shortage” which is a misnomer for Europe’s effort to buy more than it sells and to consume more than it produces. These governmental controls also include price ceilings which discourage, distort, and reduce production; priorities, allocations, and prohibitions which paralyze initiative; nationalization which brings inefficiency and increases budget deficits; and confiscatory taxes and further threats of socialization which remove whatever vestiges of incentive may be left.

Europe, in brief, has destroyed the price mechanism. It does not permit free enterprise to function. Such a condition, as long as it continues, must nullify any further help that we can pour in. As Wilhelm Röpke has pointed out in the English magazine *Time and Tide*: “Without a drastic internal reform of the national economy, to put an end to inflation and socialist controls, foreign credits can have no lasting effects, just as a man cannot be kept alive indefinitely by perpetual blood transfusions if the cause of his hemorrhage is not removed.” This is precisely what happened to our loan to England. Though we weakened ourselves by “giving blood,” England is in a graver crisis than before the transfusion was made.

Some supporters of the Marshall Plan assume that this problem can be met simply by imposing “tough conditions” with our loans. But the remedy would perhaps prove worse than the disease. Any European governments that felt forced to accept such conditions



to get the loans would resent their imposition. They would regard the conditions as an obstacle to recovery, as unworkable, as imposed primarily for the benefit of "American capitalists" rather than for the benefit of Europe. They would consider any conditions whatever as humiliating, an infringement of their sovereignty and independence. The Communists in every country have already seized upon this issue and are eagerly exploiting it. This is plain in the recent Communist manifesto and in the speeches of Zhdanoff and Vyshinsky.

And not the Communists alone. Even the usually staid London Economist, denouncing the conditions of the American loan as "crippling" and "intolerable," recently wrote: "Not many people in this country believe the Communist thesis that it is the deliberate and conscious aim of American policy to ruin Britain and everything that Britain stands for in the world. But the evidence can certainly be read that way."

Our foreign-aid policy, then, is on the horns of this dilemma. If we make loans to European governments without imposing conditions, our funds will be dissipated without bringing the recovery we seek. If we impose the conditions necessary for that recovery, we give color to the Communist contention that this is "a plan for enslaving Europe." Can we afford to hand the Communists so powerful an issue?

This dilemma is not accidental but inherent. It lies in the attempt of one government to bribe another into following economic policies which that other government does not believe in enough to follow without the bribe. ❁

## Who Told Us What?

November 10, 1947

Those who now demand a restoration of price control have one favorite propaganda device. This is to declare that those who urged the termination of price control a year and a half ago told us that prices in a free market would be lower.

Some of those who urged the end of price control did make this mistake. Why did they make it? They made it because they assumed that prices are determined primarily, if not wholly, from the side of supply. But this is precisely the error that they shared with the leading spokesmen of the Administration, including the price controllers themselves. On Feb. 14, 1946, President Truman declared: "Production is our salvation . . . Production will do away with the necessity for government control." And even Chester Bowles before

a Congressional committee on Feb. 18, 1946, declared: "Production is the only answer to inflation."

Answering these contentions in *The New York Times* of Feb. 25, 1946, I called attention to the simple fact that "prices are determined not only from the side of supply, but from the side of demand"; that demand was "far greater than it was before the war because money incomes are far greater; and money incomes are greater principally because the supply of money and bank credit has been almost tripled since the outbreak of the war." I concluded that "the solution to the problem of high prices . . . is not production alone; but that as long as money and bank credit continued to mount "they will continue to push up demand and to push upward against prices."

In his radio address of two weeks ago Mr. Truman admitted that "we are producing more goods for civilian use than ever before in history." So we now have the production that Mr. Bowles once thought was "the only answer to inflation," and that Mr. Truman himself announced would "do away with the necessity for government controls." Yet the inflationary menace seems greater than ever, and the President is demanding "emergency" controls. Why? Because, for one thing, the government has continued to follow artificial low-interest-rate and other policies that continue to increase the total volume of money and bank credit. Adjusted demand deposits of reporting member banks of the Federal Reserve System as of Oct. 22 this year were \$47,467,000,000, an increase of \$1,278,000,000 over the corresponding date last year.

Another inflationary factor is the government policy of foreign loans. As early as March 18, 1946, when price control was still in full force, I wrote in *The Times*: "Our aim should be to halt inflation, not to increase it. Yet increased export trade financed by governmental loans is clearly inflationary." At that time, however, the Administration's "economic experts" were declaring that "deflation, and not inflation, will be the big problem six months to a year from now." Replying to this contention in *The Times* of June 17, 1946, I wrote: "It is precisely groundless fears of deflation, combined with a complacent assumption that inflation is no longer a danger, that help to increase the inflationary danger." I concluded that "the prospect is still inflation."

Even today, however, Mr. Truman insists: "An attempt has been made to place the blame [for higher prices] upon our foreign-aid program, but this is not borne out by the facts." Yet it ought to be as clear as daylight that the abnormal foreign demand for our goods, coming on top of the demands of our own people, is the marginal factor that has been chiefly responsible

for the further rise in American prices. This may not be a reason for refusing help, but the Administration should at least be candid with the American people as to what the real situation is. It is a glaring self-contradiction to impose emergency “food-saving programs” and to urge us daily to make great sacrifices to supply the European demand, and in the same breath to pooh-pooh this European demand as a factor in raising American food prices.

Yet this is what Mr. Truman did in his radio address of Oct. 24, and this is apparently to be the Administration line in the special session of Congress. ❀

## Export Demand Lifts Prices

November 17, 1947

In his radio address of Oct. 24, President Truman declared: “An attempt has been made to place the blame [for higher prices] upon our foreign aid program, but this is not borne out by the facts.” His own economic agencies think otherwise. The Bureau of Agricultural Economics tells us that export demands have “generally helped to hold up” farm prices. The Council of Economic Advisers admits that “the increase in exports” in the second quarter of 1947 “undoubtedly affected the price level during this period.” It adds that “the large foreign requirements have undoubtedly been a factor in the price rise” not merely of grains but of livestock and other food products. That our export and foreign aid program has raised food prices here, therefore, ought to be beyond controversy.

But for how much of the rise has export demand been responsible? Here is a more difficult question. It cannot be answered merely by citing statistics. In the 1946–47 fiscal year our exports of wheat amounted to 34 percent of our 1946 production. The wholesale price between May 1946 and May 1947 increased 47 percent. But in the same period (according to the National Industrial Conference Board) our exports of all meats amounted to only a little more than 2 percent of our production. And their average wholesale price jumped 85 percent. Does this mean that our export program was irrelevant to the jump in meat prices?

Only those who are unfamiliar both with foodstuff markets and with the way in which supply and demand are really related will draw such a conclusion. If 100 houses are wanted by only 99 families, one house must go empty; if they are wanted by 101 families, one family may be left in the cold. The demand will have gone up only 2 percent; but the consequent increase in rents may be 20, 50, or even 100 percent. A collector at an auction

may pick up a painting, if no one else there particularly wants it, for \$100; but other determined bidders may force him to pay \$1,000. He gets the whole painting; he does not share any percentage of it whatever with the other bidders. Yet their bidding has forced up the price on him by 900 percent.

In less extreme degree these principles apply to the present situation in meat. It is impossible to tell from the actual percentage of exports what the real effect of export demand has been on the price. Meat prices, moreover, depend not merely on meat exports but on grain exports. When prices of feed-stuffs are forced up prices of meat must soon or late rise also. Grain is fed to animals only insofar as that remains a profitable procedure. Again, expected *future* exports of grains and meat are as much a factor in present prices as past exports. Finally, to produce our export surplus, wages and profits are paid out which can only be used to bid up prices of the goods that remain at home.

The President’s Council of Economic Advisers tries to belittle the effect of the export surplus by comparing it with the gross national product. It declares that “the high foreign demand has added to the inflationary pressure on prices, but the much larger domestic demand has been the principal cause of the upward pressure.” But such statements leave the real question unanswered. They are like saying, in our rent illustration, that the first 99 families have more effect on rents than the last two families. Such a statement would doubtless be true enough even if the marginal addition of the last two families raised rents, as it might, by 50 percent or more. But the real question now is: Would food and other prices have gone up at all in the last nine months, or would they have gone up even half as much as they did in that period, if it had not been for the unprecedented export demand financed by our foreign aid program?

No one can answer such a question with exact percentages. But I submit that our unparalleled export surplus, two-thirds of which has been paid for by our own government, is a major inflationary force at the present moment. It is not a service to the American people to attempt to present it as a negligible factor. ❀

## Must We Subsidize Socialism?

November 24, 1947

“Shall We Say: ‘No Aid for Socialism?’” So asks the leading piece in *The New York Times Magazine* of Nov. 9. It answers that if we don’t make unconditional loans and gifts to socialistic governments we will be “stultifying

our own assertion that we believe in democracy, and will destroy the foreign democracies themselves.”

The author of this extraordinary piece is James W. Angell, professor of economics at Columbia. Mr. Angell actually finds it “hard to see much difference in principle” between the “type of threatened coercion” practiced by Hitler on his victims and the type involved in our own government’s not making unconditional loans or gifts to foreign countries. Applying this to individuals, the professor would presumably find it “hard to see much difference in principle” between a thug’s threat to beat, blackmail, rob, or murder a businessman and a banker’s reluctance to make the same businessman a loan or a gift unless the latter first sobered up or agreed to run his business in a less wasteful and reckless manner. Both, in the professor’s abstract vocabulary, are “threatened coercion.” Either the definition of “coercion” is being stretched extremely thin or Mr. Angell’s capacity for detecting differences is alarmingly undeveloped. What he appears to be saying is that you “coerce” everybody to whom you don’t give money, and on the asker’s own terms.

Mr. Angell, who teaches economics, puts aside economic considerations as mere irrelevance, and rests his case on political grounds. He seems to feel that, as a “democracy,” we are obliged willy-nilly to pour the American taxpayer’s money into other “democracies.” The shakiness of his standards becomes evident when he explains why Russia and its “so-called” satellite states are not democratic. “This is true not because they have adopted Communist forms of *economic* organization [his italics], but principally because they are governed by minorities which have ruthlessly suppressed opposition parties and individual free speech.” One implication here is that if majorities instead of minorities were doing the ruthless suppression it wouldn’t be so bad.

Even more extraordinary is the implication that Communism’s “economic organization” and its suppression of individual freedom are quite separate things which perhaps exist together in Russia only by accident. The professor seems capable of believing, in brief, that under an economic organization in which the rulers directly control every job and every medium of expression it is only a sort of unlucky coincidence that individual freedom should not exist.

“It is perfectly true,” confesses Mr. Angell, that certain European governments that have come to us for help “have nationalized some of their industries, and that a number of them have set up state trading monopolies of various sorts. But—so what?” If we treat this taunt as a serious question, we might begin by pointing out that the professor’s statement not only minimizes

the extent of socialism and threatened socialism, but ignores altogether the currency chaos cited by the Harriman committee and the appalling network of economic restrictions that today disorganize and throttle European production. The uneasiness in Congress and the country about subsidizing socialistic governments Mr. Angell dismisses as “based on the allegation that socialism is somehow ‘a bad thing’ and morally reprehensible.” It “is not based,” he assures us blandly, “on the ground (quite possibly valid) that socialized economies are somehow less productive.”

The uneasiness, someone ought to inform him, is based precisely on that ground. The fully justified fear of many in this country is that, exactly as has already happened with our loan to Britain, any further help we pour into Europe will be more than nullified and offset by the wastage of socialistic systems that have destroyed the price mechanism and its incentives to production.

This, in fact, is the central dilemma of foreign aid. For the internal economic policies of Europe are immeasurably more important to its production and recovery than any dollars we can supply. ❁

## Back to Police-State Controls?

December 1, 1947

As a result of the shortages brought about primarily by their own economic policies, the nations of Europe have turned to the United States, the last great free market in the world, to make up the deficiency. Yet in asking Congress to aid them, President Truman proposes that we imitate over here the very network of allocations, rationing, licensing, trade controls, wage controls, and price controls that has precipitated the present European crisis.

This major irony involves minor ironies. Mr. Truman wants price controls and allocations because “grain, for example, is too badly needed to permit wasteful feeding to livestock.” Yet it is precisely government price control in France which, by underpricing wheat, has caused wasteful feeding of wheat to livestock and intensified the very wheat shortage that we are now asked to make up. It was precisely price control by our own wartime OPA that caused wasteful feeding of wheat to livestock as well as over-fattening of hogs because the OPA did not know how to set up the right corn-hog ratio.

Price fixing here, as in Europe, could only intensify shortages. American producers and consumers can solve these problems through a free market incomparably



better than any army of bureaucrats bossing them around.

Mr. Truman wants legislation permitting his new price-fixer to “impose price ceilings on vital commodities in short supply that basically affect the cost of living.” He thinks that this would not at all involve “staple food and clothing items not in short supply or . . . any delicacies or luxuries.” “Vital commodities” and “short supply,” however, are both a matter of arbitrary definition. It is difficult to imagine the future Chester Bowles making his list a short one. No producer would know when his own product was going to be added to the list.

Holding down or reducing the prices of “vital commodities” in “short supply,” moreover, would reduce the comparative profit margins on such commodities and reduce their output. The price controller and the CIO would then protest that producers were making luxuries and not necessities because the profit margin on luxuries was greater. They would demand a return to the very “overall wartime price control” which Mr. Truman says he is avoiding. It is precisely on such grounds that the OPA continued to fix the prices of Cadillacs, caviar, and mink coats, not only during the war, but after V-J Day.

Mr. Truman is trying to stop inflation by all the wrong remedies because he has forgotten its causes. When he declares that “price inflation threatens our entire program of foreign aid” he reverses cause and effect. It is the huge program of foreign aid, adding to purchasing power in this market and reducing our supply of essential goods, which has been the marginal cause of the present price rise. The basic cause of inflation here has, of course, been the increase in money and bank credit brought on by the government’s own fiscal policies. Mr. Truman wants new powers by the Federal Reserve authorities over consumer credit and the banks. But he does not tell us why they have failed to use (except in order to increase the inflation) their traditional and more than adequate powers over open market operations, rediscount rates, and reserve ratios.

The spectacle of a government’s assuming to protect us from the consequences of its own policies by asking for more powers against “speculators,” producers, and “profiteers” is not novel. Writing a century ago, John Stuart Mill declared: “It is not, however, so much the general or average price of food, as its occasional high price in times of emergency, which governments have studied to reduce. In some cases, as for example the famous ‘maximum’ of the [French] revolutionary government of 1793, the compulsory regulation was an attempt by the ruling powers to counteract the necessary consequences of their own acts; to scatter an

indefinite abundance of the circulating medium with one hand, and keep down prices with the other; a thing manifestly impossible under any regime except one of unmitigated terror.” ❁

## Cheap Money Means Inflation

December 8, 1947

The Administration valiantly continues its efforts to protect the American people against the consequences of the inflation that its own policies have brought about. While it lectures “businessmen, bankers, labor leaders, farmers, and consumers”—in short, all the rest of us—on what we should do by our own “voluntary efforts” to “hold prices down,” while it asks for still further powers to crack down on alleged “speculators” and “profiteers,” it blandly continues to feed the fires of inflation by its own acts. It can do this because most laymen do not understand the consequences.

For generations economists and bankers have recognized that artificially low interest rates—i.e., cheap money policies—are inflationary. The chain of causation is simple. Artificially low interest rates increase the demand for loans. Increased bank loans mean a corresponding increase in bank deposits. Increased bank deposits (against which checks are drawn) are just another name for an increase in the money supply. An increase in the volume of money is only another name for an increase in monetary purchasing power pushing up the prices of goods. A cheap money policy, in brief, is the keystone, the central support, of an inflationary policy.

This fact is too patent even to escape the attention of our monetary managers. They concede it in left-handed ways. Testifying on the President’s “anti-inflation” program before the House Banking Committee, Secretary Snyder declared: “To minimize bank credit expansion, restrictive measures have been applied to the money market by the Federal Reserve System and the Treasury. This has been reflected by a rise in interest rates.”

Here is an admission of the close causal connection between low interest rates and bank credit expansion, on the one hand, and between bank credit restriction and higher interest rates on the other. It is an admission that low interest rates are inflationary. Yet in reply to a question the Secretary declared that the Treasury did “definitely not” contemplate any policy that would cause a rise in the present infra-low interest rates. This is tantamount to saying that the Treasury definitely intends to continue this basic inflationary policy at the same



time as it presses for ineffective and dangerous “anti-inflation” measures.

There are several reasons for this glaring self-contradiction. The Administration wants to eat its cake and have it too. It wants all the popular benefits of an inflationary boom with none of its unpopular embarrassments. Its most immediate fear is that higher interest rates would cause a decline in the price of government bonds. A fall in government bond prices would, of course, unless some special provision were made, adversely affect the banks of the country that are loaded up with these bonds.

There is not space here to discuss the possible ways of extricating ourselves from this dilemma. It is precisely because a cheap money policy creates such grave problems, indeed, that it ought not to have been recklessly embarked upon in the first place. To continue such a policy would merely intensify the danger and the later difficulty of arresting or reversing it.

In defending the continuance of an inflationary low interest policy, Secretary Snyder declares that “an increase of  $\frac{1}{2}$  of 1 percent in the average cost of carrying the public debt, for example, would mean an added burden of \$1,250,000,000 a year on the taxpayer.” This is obviously a narrow and shortsighted way to look at the problem. Against this “saving” we must count the inflationary cost to the American people, both as taxpayers and as consumers, of a policy of *not* raising interest rates to curb inflation. This annual “saving” of \$1,250,000,000 to the taxpayers in government bond interest could be far more than wiped out by a forced inflationary increase of \$5,000,000,000 or more in *all other* government expenditures, including those for materials, wages, and salaries, or by a \$20,000,000,000 increase or more (here it is impossible to set definite limits) to what American consumers would have to pay to keep the same standard of living that they have now. ❁

## Can We Buy Off Communism?

December 15, 1947

The program of huge loans and grants from our own to foreign governments is supported by a variety of motives, but the dominant if not determining purpose today is “to stop Communism.” The recent statement of Senator Ives that “all of Europe is apt to go Communistic within a relatively short time without outside aid” is typical of a widespread Congressional attitude.

I certainly do not wish to minimize the Communist danger, but rather to raise the question whether turning a large amount of the American taxpayers’ money over

to unsteady European governments representing various shades of socialism is really the most appropriate or effective means to combat that danger. Apparently the reasoning behind the belief that we can buy off Communism with foreign loans or gifts is that nations embrace Communism because they are poor or in economic distress. It seems to be assumed that if we throw in enough American funds or goods to raise their standard of living, these nations will be “strong enough” to reject Communism and perhaps even to adopt free enterprise.

The faultiness of this reasoning should become clear at the moment we confront an actual situation. The Communist-led strikes in Italy and France can nullify our aid, but our aid cannot nullify the strikes. If the French and Italian Governments, for whatever reason, cannot prevent these disruptions to output, far more production will be destroyed within France and Italy than imports from us can make up. We accomplish nothing merely by paying for French and Italian strikes. To combat Russian aggression and world Communism requires far harder decisions than the comparatively easy and somewhat evasive one of merely giving away more American dollars.

We have been confusing cause and effect. It is not true that the nations of Europe are in danger of Communism today primarily because they have run into a series of economic crises. They have run into these crises, rather, mainly because they have adopted monetary inflation, dictated economies, and socialistic controls which have destroyed the price mechanism and its incentives. In brief, it is not true that Europe needs an economic recovery before it can return to ideological soundness. It needs the ideological recovery first, before it can hope for the economic recovery. And until the ideological recovery takes place, the internal policies of Europe will more than nullify, as the case of England has proved, any help we can pour in.

One very hopeful sign of reform is the action of Italy in permitting its currency unit to seek its approximate market level. This meant immediately cutting the official rate of the lira from 350 to the dollar to about 589. The effect must be to stimulate Italy’s export trade, by making its prices more attractive in terms of other currencies. If this is accompanied by other moves toward free markets, and not offset by Communist disturbances, it could bring a dramatic recovery.

On the other side, unfortunately, has been the strengthening of the Labor party’s hold on the British economy through the Gravesend by-election. This was probably brought about, ironically enough, by President Truman’s appeal for the reimposition of price and other

controls here. A week before the election took place The New York Times reported from England that Mr. Truman's appeal had become "a major factor" in the Gravesend campaign, and that the Labor party's prospects had been "perceptibly improved" by it. "Do you stand with Attlee and Truman on the controls issue," asked the Labor candidate, "or with Churchill and the price racketeers?"

The argument that Europe has had to adopt "distress socialism" until its economic condition improves rests on the assumption that free enterprise is a luxury that only a rich or already recovered country can afford. The truth is that free markets, with their unrivaled incentives, will bring a faster revival of balanced production than any other system. It is precisely *because* Europe is in distress that it needs free enterprise now. ❁

## Our Inflationary Bond Standard

December 22, 1947

Any return to a system of government wage and price fixing would dislocate profit margins, dampen incentives, and disorganize production. And proposals for such a system, by centering public attention on false remedies and on symptoms instead of causes, tend to divert that attention from the real causes of inflation and the real remedies for it.

The basic cause of inflation, always and everywhere, lies in the field of money and credit. It is unfortunately assumed that money and credit inflation can safely be ignored today because the Federal budget, for the first time in sixteen years, is balanced. This is like assuming that a river reaches high-water mark the moment the rain has stopped. On the contrary, it keeps rising because it continues to be fed from a thousand swollen rivulets and flooded fields.

Chairman Eccles of the Federal Reserve Board has testified before a Congressional committee that "under present and prospective conditions, it is not only desirable but essential, in the opinion of the Treasury and of the Reserve System, that the established 2½ percent rate on long-term marketable government securities be maintained." This means, as Mr. Eccles does not hesitate to make clear, that the Federal Reserve will continue to stand ready to buy all government securities offered to it at par or present prices. It is pegging the price. "Such sales *have to be met* [my italics] by Federal Reserve support of the prices of marketable government bonds so as to protect the 2½ percent rate on long-term issues." And "the result of these support operations is

to increase bank reserves and thus to support further inflation."

How much inflation? Mr. Eccles is disarmingly frank about that, too, "Commercial banks currently hold about \$70,000,000,000 of government securities. This sum is about 50 percent of their total deposits. If they should sell half of these securities and the Federal Reserve System, in providing the ultimate market, should buy them, the banks could acquire an equivalent volume of new reserves. On the basis of these reserves, the banks could expand credit by about six times, or by more than \$200,000,000,000." We have, in short, the testimony of our highest banking official that as long as the Federal Reserve Board continues its policy, the country faces a huge potential further inflation.

How do the Treasury and the Federal Reserve propose to deal with this danger? They refuse to take the one step that could bring it to a halt. That would be to stop providing an automatic market at current interest rates for government securities. What Mr. Eccles asks for, instead, is power to set up a "special reserve" of a maximum of 25 percent on demand deposits of all commercial banks. This "reserve" would be composed not primarily of cash but of "Treasury bills, certificates, and notes." Of course, to call this a "reserve" is a misnomer. It could not be paid out to depositors demanding cash. It would be, in fact, a requirement that a minimum proportion of the commercial banks' loans and investments be in short-term government securities. It is an attempt to establish another automatic market for such securities.

It is an attempt, in Mr. Eccles's own words, to "divorce the market for private debt from the market for government securities." In the long run such an attempt could not succeed. If the yield on other securities went up while that on government securities stayed down, such a plan would merely drive *all* government securities into the banking system, where they would become the basis for further credit. On Mr. Eccles's own testimony his plan would allow a potential credit expansion two and a half times as great as the government securities held.

The United States today is not on a gold standard, except in a Pickwickian sense. It is, as the economist Melchior Palyi has put it, on an inflationary bond standard, the essential feature of which is the automatic monetization of the national debt. And attention is merely diverted by the Administration from this potentially explosive reality when it asks for power to dictate wages and prices. ❁

## Inflation Has Two Faces

December 29, 1947

In his message to the special session of Congress, President Truman correctly declared: "We already have an alarming degree of inflation; and, even more alarming, it is getting worse." Yet like the present leaders of most other countries, Mr. Truman and his economic advisers refuse to attack inflation at its source by halting the further expansion of money and bank credit.

The chief reason for this failure to attack fundamentals is not merely that the public in general does not understand the real cause and cure for inflation, but that it presents no united front against inflation. Its feelings about it are confused and ambivalent. And this is because inflation, like Janus, has two opposite faces. Whether we welcome or fear it depends upon the face we happen to look at. Or, putting the matter another way, we are each of us sometimes Dr. Jekyll and sometimes Mr. Hyde in our attitude toward inflation, depending upon how it seems to affect our personal interest at the moment.

All this is vividly illustrated by Mr. Truman himself. He points with pride to the results of inflation at one moment and denounces them the next moment. He claims credit for its popular consequences and blames the Republicans for its unpopular consequences. Like the rest of us, the President wants to have his shoes small on the outside and large on the inside.

For it should be obvious that high prices, which everybody affects to deplore, and high money incomes, which everyone wants to achieve, are two sides of the same thing. Given the same amount of production, if you double the price level you double the national income. When the President boasted last July that we had "surpassed previous high records" with a gross national product of \$225,000,000,000, he was boasting in large part of the higher dollar totals you get when you multiply volume of output by higher dollar prices.

At one point in his "anti-inflation" message Mr. Truman declared: "In terms of actual purchasing power,

the average income of individuals after taxes has risen [since 1929] 39 percent." But a little later he was asking, inconsistently, how "the cost of living can be brought and held in reasonable relationship to the incomes of the people." Yet if the incomes of the people have in fact already risen so much faster than living costs that the individual can buy nearly 40 percent more goods than he could before, in what does the present "emergency" consist?

"Rents are rising," complained Mr. Truman at another point, "at the rate of about 1 percent a month," and such a rise imposes an "intolerable strain" upon the family budget. But as the average weekly earnings of factory workers have gone up 112 percent since 1939, while rents have gone up only 9 percent, the average worker pays, in fact, a far smaller percentage of his income for rent than he did before the war.

"The harsh effects of price inflation," said Mr. Truman at still another point, "are felt by wage earners, farmers, and businessmen." Clearly this cannot refer to the inflation of their own prices, but of somebody else's. It is not the prices they get for their own goods and services, but the prices they pay for the goods and services of others, that they must regard as "harsh." Why, of all groups, does Mr. Truman now shed tears over the farmer? It should be pointed out that the wholesale price of farm products has gone up 191 percent from the 1939 level as compared with an average of 107 percent in all commodities.

The real evil of inflation is that it redistributes wealth and income in a wanton fashion often unrelated to the contribution of different groups and individuals to production. All those who gain through inflation on net balance necessarily do so at the expense of others who lose through it on net balance. It is an illusion to suppose that the losers can ever be brought abreast of the gainers except by setting the gainers back. And it is often the biggest gainers by inflation who cry the loudest that they are its chief victims. Inflation is a twisted magnifying lens through which everything is confused, distorted, and out of focus, so that few men are any longer able to see realities in their true proportions. ❁

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## The Uncalculated Risk

January 5, 1948

It has become fashionable to say that while the Marshall Plan does not guarantee European recovery or a peaceful victory over Communism it would be cheap even at \$17,000,000,000 if it did bring these results. We are told that we are asked to take no more than a “calculated risk”—a gamble for tremendous stakes in which the odds are heavily in our favor. This argument, however, begs the central question. It takes it for granted that the European Recovery Program, in the form now proposed by the President, could do only good and no harm.

Yet Europe’s economic crisis today is only partly the result of war destruction or of bad weather. It has been brought on mainly by Europe’s own economic policies, which have destroyed the free-market mechanism and its incentives. Nearly everyone seems to assume that if this self-imposed crisis deepens, or if controls intensify shortages, Europe will turn in desperation to still more drastic controls and even to Communism. The Marshall Plan, it is thought, will prevent this by making the situation better.

It never seems to occur to those who hold this view that a deepening of this self-imposed crisis could lead to a demand in Europe, not for Communism but for a return to economic freedom. Yet there are already encouraging signs of this. Italy has restored relative freedom of foreign exchange. France has dropped some important controls. Former Premier Daladier recently declared in debate that inflation cannot be overcome in France as long as a managed economy prevails. In Britain the public faith in the managed economy has been visibly slipping. Is there not a real risk that the funds and goods supplied by the Marshall Plan, by making the situation more tolerable than it otherwise would be, could delay or prevent a return in Europe to free markets and free enterprise? Will the Marshall Plan be in fact so framed and administered as to save socialistic Europe from Communism? Or will it be so framed and administered as to save Europe from capitalism?

At present, certainly, these questions cannot be answered with confidence. In his message to Congress on the Marshall Plan President Truman admitted that our proposed \$17,000,000,000 of help to sixteen European nations would constitute only some 5 percent of their total national production. Yet he declared the “two purposes” of our help to Europe to be “to lift the

standard of living in Europe closer to a decent level, and at the same time to enlarge European capacity for production.” Would a 5 percent difference in its standard of living decide socialistic Europe to return to capitalism instead of driving on to Communism? “To enlarge European capacity for production” is to supply Europe with capital goods. To the extent that we do this we must necessarily defer our own capital expansion. Are we going to do it while Europe continues to follow the policies that systematically throttle its own capital production and investment—price fixing and profit control which discourage the output of capital goods and plant expansion; drastic income taxes that dry up the sources of capital accumulation; threatened socialization and seizures that discourage or prevent private investment?

Yet in the President’s message there was not one serious word of criticism of the economic policies now being followed by European governments. There was not one hint that these policies have been in any way responsible for the present European crisis. Nothing was said of the effect of overvalued currencies in discouraging exports. European promises for the future were taken as the equivalent of accomplished facts. Mr. Truman warned Americans against the consequences of providing “only halfhearted and halfway help.” He said nothing of the consequences of half-hearted and halfway self-help in Europe. Yet on the President’s own estimate what Europe does to increase its own production will be at least twenty times as important as the American contribution.

It is clear that the risks of the Marshall Plan, in the form in which it has been presented to Congress, have not yet been soberly calculated. ❁

## A Century of Communism

January 12, 1948

It may come as a shock to many people to realize that socialism and Communism as we know them today—the Marxist brand—are now officially a hundred years old. For it was in January 1848 that the manuscript of the *Communist Manifesto*—by far the most influential single document of the cause—was written by Marx and Engels.

In the century since its publication it has proved its viability as a masterpiece of pamphleteering and propaganda. From its opening sentence: “A specter is haunting Europe—the specter of Communism,” to its famous

conclusion: “Proletarians have nothing to lose but their chains. They have a world to win, Workers of all lands, unite!”, the Manifesto has a startlingly “modern” ring. Yet it is hard to say whether this contemporaneity is primarily a tribute to the polemical genius of Marx or a reminder of the intellectual poverty and docility of his epigones. For not only the declared Socialists and Communists, the conscious disciples of Marx, but thousands of people who think of themselves simply as “progressives” and “advanced” original thinkers, and who have never read Marx at first hand, parrot his phrases and have adopted some of his anti-capitalist theories. Many a magazine editor could have saved good money in the last two decades by running excerpts from the Manifesto instead of buying articles which were little more than paraphrases of such excerpts.

It is all here—the “class struggles” and “class antagonisms” (with “classes” never clearly defined); the “need for ever-expanding markets” and for “the conquest of new markets” (which Russian Communists still think is one of the main motives behind the Marshall Plan); the “concentrated ownership in the hands of the few” (“proved” mainly by constant reiteration); the “epidemics of overproduction” (still the most popular theory of crises among our “progressives”); the workers who are “slaves of the bourgeois class”—and all the rest.

There is even the preposterous theory that capital accumulation, the use of machinery, *increases* “the burden of labor” and “forces wages down almost everywhere.” Does this sound too absurd for present belief? Then listen to its echo in the second annual report just published by the President’s Council of Economic Advisers: “The accumulations of capital over the years have in fact involved deprivations of the rank-and-file worker.” No doubt this explains why in the United States, where the accumulation of capital and the use of machinery have reached their highest levels, wages and economic welfare are notoriously the lowest in the world.

The Manifesto is not only belied by the facts of today but contains inherent theoretical self-contradictions. Though the marginal-utility champions were undermining the classical value theory in Marx’s own lifetime, he never extricated himself from the Ricardian cost-of-production doctrine. And to the end of his life he never reconciled his hysterical incitements to revolution with his fatalistic theory that the victory of the proletariat was “inevitable” anyway.

In the Manifesto Marx frankly demanded “despotic inroads upon the rights of property” and “despotic interference with bourgeois methods of production” by measures which he regarded as necessary to pave the

way for revolution. In his list of ten such measures he placed *second* “a vigorously graduated income tax.” Surely his ghost must gloat as it reads the American and British income-tax schedules of today.

Marx had a genius for destruction. He knew that capitalism could not long survive a system of confiscatory taxes which dry up incentives and the sources of private capital accumulation and investment. Like his disciple Lenin—who declared that the best way to destroy the capitalist system was to debauch the currency—he probably would have seen that the undermining effects of the present “vigorously graduated” income tax are merely being concealed for the moment by the effects of monetary inflation. In the end, he knew, this “despotic inroad upon the rights of property” must do its destructive revolutionary work. ❁

## Blueprint for Disruption

January 19, 1948

President Truman’s annual message to Congress was primarily a campaign document. It seems to have been written chiefly in fear of losing extreme leftist votes to Henry Wallace. The basic philosophy it embodies is unmistakable. It is the philosophy of the welfare state, the doctrine of salvation through bureaucracy. Free enterprise, free markets, and free prices are no longer to be trusted to stimulate and guide production and consumption. Everything is to be in charge of omniscient and omnipotent bureaucrats.

Everyone is promised economic security, regardless of what he contributes to production. We are to have bigger job insurance, bigger old-age benefits, bigger survivors’ benefits, bigger education. The government is to subsidize our medical care and our housing. It is also to reclaim land, replant forests, build more TVA’s. On top of this, it is to spend in fifteen months on European aid alone as much as it used to spend in the same period before the war for all its purposes combined.

Mr. Truman, by some miracle, is at the same time for “economy.” “Government expenditures have been and must continue to be held to the lowest safe levels.” But the proposals he makes would immeasurably increase even present expenditures. And the Federal government is already spending in one year as much as it took it five years to spend just before the war. Of course all this money is to be taken in taxes only from “the rich.”

What Mr. Truman forgets is that the entire wealth and welfare of the country depends upon production. The total amount of the national product is far more important to the average family than any possible redistribution of it. Yet Mr. Truman's schemes and taxes would undermine, discourage, and disrupt production. It would destroy incentives. The producers would not be permitted to enjoy the fruits of their production, and others would be handed the fruits whether they produced anything or not.

Mr. Truman's speech is a tissue of self-contradictions. He is for "free enterprise" and "free competition," but demands price fixing. He wants to "continue price supports for major farm commodities." But he declares that the price of food is too high and that it must be reduced by government edict. While prices are to be held down, costs of production are to be forced up. The minimum wage is to be increased from 40 to 75 cents an hour. This would be a wage boost of 87½ percent. All workers above the minimum would of course insist on the maintenance of their existing differentials. Production costs and prices would be forced up enormously, and this might cause heavy unemployment even in spite of monetary inflation. If we can raise wages just by passing a law, and do it without such harmful consequences, why not \$1 an hour or \$2 an hour? Why stop anywhere?

We must enlarge our industrial capacity, continues Mr. Truman: "At least \$50,000,000,000 should be invested by industry to improve and expand our productive facilities over the next few years." But such funds could only be provided out of past profits and would only be invested if there were an inviting prospect of future profits. Yet Mr. Truman is shocked by existing profits, even though, as a percentage of the national income (especially when proper allowance is made for depreciation and inventory replacement) corporate profits today are not at all abnormally high. Mr. Truman wishes to increase taxes precisely where the increase would do most damage to production—on the corporations that are the very means of the workers' livelihood. He would do this in order to free some 10,000,000 voters in an election year from all income taxes, and to create the short-lived illusion that present enormous government expenditures can be paid for only by a minority, by "the rich," by "somebody else."

Candidate Truman's program is demagoguery run riot. It is a blueprint for disruption. He asks this country to imitate slavishly all the disastrous economic policies that have brought Europe to its present critical state, and he wants us to call this process American "leadership." ❁

## Marshall Plan Pro and Con

January 26, 1948

Henry Hazlitt and Ernest K. Lindley

### LINDLEY: U. S. DOLLARS NOW OR AMERICAN LIVES LATER

No discussion of the Marshall program should lose sight of the central question: Is Western Europe to survive as a community of free nations?

Western Europe is the world's second greatest workshop. Its 270,000,000 people have ways of life and ideals similar to ours. Most of them (Germany is the most important temporary exception) live under freely elected governments, all of which are at present non-Communist. Several of these nations are, moreover, the hearts of commonwealth and colonial systems embracing large parts of the earth.

The crumbling of Western Europe would be catastrophic for us. Without our support, Germany, Italy, and Greece almost certainly would go Communist quickly. In some of the other Continental nations, the first turn might be to the right—not to the free enterprise right, but of necessity to more or less totalitarian regimes. These could not stand in the long run, however, without our support, military as well as economic: The British position would be worsened immeasurably, at great added cost to us.

In two-and-one-half years since the war, Western Europe has made substantial recovery. Production in Britain, France, and seven other Marshall-Plan nations is up to or above prewar. Why, then, is further aid from the United States needed?

Before the war, Europe paid for one-fourth of all its imports by income from shipping, foreign investments, and other invisible exports. It got dollars also from the sale of colonial products to the United States. These sources of income have not yet been fully restored; parts of them are gone forever.

Some of Europe's imports and production since the war have had to be used to repair war damage, a job which is far from complete. The population of Western Europe is 25,000,000 above prewar. There are other factors, but these, plus the lag in Germany, are enough to explain why, in spite of substantial recovery, Western Europe generally has not yet achieved either a tolerable standard of living for its people or the capacity to make its own way.

A critical juncture has now been reached. Without further aid from us, Europe will slide back, instead of going forward, simply because it is not yet able to pay for all the food, fuel, and raw materials it must import to keep its plant going, and for the fertilizer



and equipment it must have to restore and enlarge its production.

The Marshall Plan is designed to enable Western Europe to push on to the point where it is once again self-supporting. The American contribution is calculated to provide only the indispensable margin of outside aid. This is not large in relation to the resources either of Europe or the United States. The first year, which should be the most expensive, will cost less than we spent in three weeks of war. It does not impose a new or increased strain on our economy. The rate of export called for is below that of last spring. And it is estimated that, even with the full Marshall program, our total excess of exports over imports will be smaller in 1948 than in 1947.

We will have to do without some food, fertilizer, and other things that we could use, but we will have more left, over all, for ourselves than ever before. The assertion that we can't stand this relatively small call on our resources is preposterous. The burden is small compared with the war, with the huge outlays for defense that will be imperative if Europe crumbles, not to mention another war.

To get the maximum benefit from this program—indeed to give it a fair chance to succeed—we must give the European partners assurance that we intend to see it through. This can best be done, I think, by authorizing the administrative machinery for at least four years. An adequate initial appropriation is also essential. A niggardly sum would not generate the economic and political forces necessary to full recovery. The European partners must, of course, be required to live up to their pledges to put their internal finances in order, to lower artificial trade barriers, etc.

If we do not extend to Western Europe the relatively small amount of help it must have for the next few years if it is to survive as a community of free peoples, we will pay an infinitely greater price later—a price which almost certainly will have to be reckoned not only in goods and dollars, but in American lives.

#### **HAZLITT'S REBUTTAL:**

Whether Western Europe survives as a community of free nations (which Lindley rightly considers the "central question") will depend chiefly upon two things: first, the economic and political policies followed by the nations of Western Europe; and second, the diplomatic and military policies followed both by them and by our own government in relation to Russia.

In this situation the Marshall Plan becomes secondary and almost an irrelevance. Yet it is being used by the Administration as a substitute for the hard diplomatic decisions that will finally have to be made. We

are now challenged by Russia diplomatically and militarily on three chief fronts: China, Greece, and Berlin. If we are to prevent further catastrophes, our diplomatic policy on all three must be firm and unmistakable. It is in fact uncertain and ambiguous. The pleasant illusion that we can buy off the Russian nightmare merely by turning a few billions more of the American taxpayers' dollars over to socialistic European governments cannot much longer be maintained.

We cannot even buy European recovery with it, any more than we bought British recovery with our \$3,750,000,000 loan to Great Britain, because Europe is not following the policies that can bring about such recovery. Our postwar loans and grants so far have largely gone into subsidizing and prolonging price control, exchange control, and socialism that directly hinder European recovery. There is no guarantee that the continuance of our largess under the Marshall Plan will not make this situation worse.

Lindley stresses the loss of Europe's invisible exports. The total net loss in Britain's income from foreign investments, shipping, and other invisible items since the war (disregarding its foreign occupation costs) has been about £118,000,000. Those who are impressed by the calculation that the Marshall Plan would cost us less than 3 percent of our own national income, might remind themselves that Britain's loss in invisible exports as compared with 1938 is only 1½ percent of its 1946 national income. For those who are impressed by percentages this is hardly a substantial lowering of its standard of living.

#### **HAZLITT: WE CANNOT BUY OFF THE RUSSIAN NIGHTMARE**

My misgivings about the Marshall Plan are not based on "isolationist" but on international premises. The proponents of the plan are right, as I have previously pointed out in this column, in believing that there is an economic crisis in Europe. They are right in realizing that our own economic and political future will be deeply affected by the fate of Europe. They are right in urging that we should do anything we can that promises to increase Europe's welfare without imperiling our own.

But the all-or-nothing advocates of the Marshall Plan harbor serious misconceptions both of major economic facts and of major economic principles. They overestimate both the shortages of Europe and the resources of the United States. In his testimony before the Senate Foreign Relations Committee, to cite a single example, Secretary Marshall made the astonishing statement that the war "destroyed livestock herds" in Europe. Yet volume two of the report of the sixteen nations, published by the Department of State, shows

that cattle on the hoof in those nations is in excess of 64,000,000, as compared with an average of less than 62,700,000 in the four years before the war.

The all-or-nothing advocates of the Marshall Plan, on the other hand, greatly overestimate American food resources. Before the war this country produced less than 9 percent of the world's food supply. Even today it produces only 12 percent, or about one-eighth. Most of us have forgotten that before the war we were on net balance a food *importing* country. We think, for example, of the wheat we sold abroad; we forget that we bought from abroad several times as much sugar. From 1936 to 1940, we exported an average of \$294,000,000 of food-stuffs a year: we imported an average of \$665,000,000 worth.

Another misconception of the all-or-nothing Marshall Planners arises out of invalid comparisons with the national-income figures. From the President down, they have belittled the huge burden of the Marshall Plan by declaring that "it will cost less than 3 percent of our national income during the life of the program." Passing over the question of how reliable our national income estimates really are, such a comparison is meaningless. In 1939 the value of our entire wheat and cotton crops added together was less than 1½ percent of the then national income. The entire annual coal output of this country, bituminous and anthracite, is valued at less than ½ of 1 percent of the national income. But if this coal output were suddenly to stop, or if it were all shipped to Europe, we would not retain the other 99½ percent of our national income. The greater part of American industry would simply come to a halt.

Our economy is a closely interdependent living organism. If a man loses his right hand or his left lung you do not console him by measuring the loss merely as a percentage of his total weight. Shylock's little joke was that his single pound of flesh was to be taken "nearest the heart."

Our exports under the Marshall Plan must be measured, not in terms of abstract percentages, but in terms of where they impinge and on what they will do to our entire economy. We are not shipping out 2 or 3 percent of our wheat crop, but 40 percent. Such shipments have sent wheat prices and food prices skyrocketing, have boosted everyone's cost of living, and have already put great distortions and strains on our internal economic relationships. It is time we heard the last of this belittling and meaningless 3 percent figure.

I must return, finally, to the general point I have made repeatedly both in previous columns and in my book *Will Dollars Save the World?* The Marshall Plan is based on the mistaken belief that the present

economic troubles of Europe are chiefly the result of war destruction.

But the truth is that Europe's economic crisis today is chiefly the result of its own postwar collectivist and inflationary policies. So long as its governments continue these policies, no aid that America could grant would be adequate to bring recovery. But if Europe returns to free markets and sound money, a dramatic revival could take place even without any further government financial aid from us, except food till the next crop comes in.

#### LINDLEY'S REBUTTAL:

The patient is recovering from compound fractures of all limbs, concussion, and double pneumonia, in an underheated room and on an inadequate diet. Hazlitt's diagnosis is: boils and incomplete mastication. He rebukes the patient and prescribes: no more food until you have proved that you have learned how to chew it thoroughly. The result of this "cure" can only be death.

There is general agreement about some of the financial and economic steps that should be taken in Western Europe. The most important are pledged or inherent in the Marshall Plan. But even if Hazlitt's advice were followed to the last tittle, it would be fantasy to suppose that Western Europe could become self-supporting without a further infusion of working capital. I have cited some of the important reasons. There are many others, including Russian control of Eastern Europe and Communist activities within Western Europe.

To support his thesis that we cannot afford ERP, Hazlitt takes as an example food, especially wheat. There is no intention of continuing the wheat exports at this year's exceptionally high level, occasioned by the worst crop weather Western Europe has had in decades. Wheat exports scheduled under ERP are much smaller—300,000,000 bushels at the highest, as against the 500,000,000 in this crop year.

Overall food exports projected under ERP are lower in recent years. And, literally, they do not include for Europe a single pound of edible flesh, except horse meat.

In this space I can touch on only one more point. Hazlitt appears to feel no basic difference between Communists and Socialists. Even if the latter are wrongheaded in their economics, they are on our side in the critical struggle to save Europe as a community of free peoples. They stand as a bulwark against Soviet Communist ambitions. That is why Cominform assails Attlee, Bevin, Blum, and others so ferociously as enemies of the working class, just as it assails others who support the Marshall Plan but not those who, like Hazlitt, are against it. ❁

## How to Get Rid of Rent Control

February 2, 1947

The politicians insist that this country needs most of all new and better rental housing. To encourage this, they penalize and punish most of all precisely the people who have supplied us with the rental housing we already have. Rents are today only 15 percent above the 1935–39 level, though clothing is 90 percent above and food 103 percent above. All items together average 65 percent above. Compared with the increase of 15 percent in rents, average weekly wages of factory workers have increased 127 percent. In short, the average worker's rent is a smaller percentage of his income than ever before. Yet President Truman recently called the rent rise an "intolerable strain" on family budgets. And if Washington seems agreed upon any one thing, it is that rent control must be extended unimpaired.

The defense offered for rent control is that the supply of housing is "inelastic," and that higher rents, except those permitted on new housing, do nothing to encourage the construction of new housing. (Though we were once insane enough to put rent ceilings even on housing not yet built.) This defense overlooks the fact that compulsory low rents on old housing do two things. They encourage wasteful use of space by tenants already in possession, and so intensify the housing shortage for people unlucky enough to be caught outside. And they remove both the incentives and the funds to improve old houses or even to keep them in repair.

The classic illustration of these consequences today is in France. France has now had rent control for 33 years. Tenants in France now pay from 5 percent down to as little as 1 percent of their annual incomes for rent. The result is that houses in France are in a wretched state of disrepair and decay, inside and out. And their condition steadily grows worse. It is true that newly built houses are not subject to rent control. But builders no longer trust the government not to change its mind about that after the houses are up.

Moreover, though rents in France average only five times as high as in 1914, building costs are 65 times as high. New buildings, therefore, would have to rent for something like ten times the rent of old buildings. A public habituated to ridiculously low rents would resent this as an outrage. So the new houses are not built.

The longer rent control is retained, the greater its problems become; and the greater the problem of ever getting rid of it. How can we keep ourselves from going the way of France?

This is a political problem. Congress is now certain to extend rent controls. When it does it should at least

provide that on and after March 1 any state in the union, or even any home-ruled town or city, will be permitted to take over rent control from the Federal government at its own request. That would relieve Congress from a frightful future headache. More importantly, for those to whom such things still matter, it is the only constitutional thing to do. There is not in the American Constitution a single clause that could possibly be interpreted to give the Federal government the right to regulate rents in peacetime. If rents are not essentially local, nothing on earth is local. Houses and apartments don't wander across state lines.

To discourage individual states and cities from keeping rent control indefinitely, as in France, Congress might provide or recommend that any community taking over rent control should taper it off in not more than five years under some such formula as this: In 1949 it should allow rents to be raised at least 20 percent as much above the 1941 level as all other items on the official consumers' price index had gone up as of Sept. 15 of this year; in 1950 it should allow rents to go up 40 percent as much as other items; in 1951, 60 percent as much; in 1952, 80 percent as much, and in 1953 just as much, with a termination of rent control thereafter.

This, of course, for five years would be obviously unfair to landlords as compared with other producers or sellers, but not as unfair as retention of the present system. And it would get us back to free rents at least eventually, on a definite schedule, and with a minimum jolt to tenants. ❁

## France at the Crossroads

February 9, 1948

On Jan. 25, the French Government slashed the official value of the franc from 119 to the dollar to 214. At least the same time it also permitted the establishment of a free market in the franc in terms of the American dollar.

This step brought consternation to British Government circles and to the International Monetary Fund. For it will expose not only the weakness of the pound, but the unworkability of the whole system of world exchange control that the fund was set up to maintain.

The fund declared that it did not object to the devaluation of the franc to a more "realistic" rate, but that it did object to "a discriminatory multiple currency practice." It admitted, however, that it had "serious reservations regarding a system involving fluctuating rates." This was equivalent to saying that it doesn't like a free market.



The fund is based on a false concept of what constitutes “stability.” The only real stability for exchange rates is one that rests on confidence. This was provided by the old world gold standard. When each currency unit was convertible into a fixed quantity of gold, the value of each currency unit could be expressed as a fixed ratio of every other. When the world gold standard was abandoned, nothing was left but pieces of engraved paper within each country, which necessarily bore an uncertain and constantly fluctuating relationship to the value of the other pieces of paper. The fund was set up to maintain the colossal fiction that each currency is worth, in terms of other currencies, what the government that prints it says it is worth. Instead of real stability resting on confidence, the fund and its members have tried to substitute the fiction of stability resting on coercion. The governments fix the values of their currencies by fiat: and then call out the police to put anybody in jail who dares to express through his purchases and sales a different opinion.

Of course mere paper currencies, constantly fluctuating in the market, are far from an ideal system of foreign exchange. But a free fluctuating market is at least incomparably better than the mere fiction of stability maintained by the police power. A free market adjusts supply and demand. It daily tells the world what different currencies are really worth. It would end the so-called dollar scarcity. It would end inconvertibility, and with it the present hocus-pocus about “hard” currency areas and “soft” currency areas. It would restore the balance of imports and exports. It would restore multilateral world trade. The British could get dollars by selling to France or China, for example, just as easily as by selling direct to us. And only free markets could guide governments in finding the level on which they could finally stabilize their currencies on a solid gold basis.

British officials are dismayed by the French action because it exposes the pretenses of the pound. The pound isn't worth \$4. This is the bitter truth that the British Government has so far refused to face. The present fictitious value for the pound is not merely exposed but imperiled by the French free market.

How will the British be able, without French help, to prevent Americans from buying francs, say, at 340 to the dollar, and then exchanging the francs at the new official rate of 864 to the pound, thus buying pounds for the equivalent of \$2.54?

America ought to be the last country to want to continue the present system of exchange control and overvalued currencies. It is we who have been asked to foot the bill. It is we who are financing—and are asked

to continue to finance under the Marshall Plan—the chronic deficit in European trade which these overvalued currencies bring about.

The French action is the first major crack in the present world system of exchange control. This system is the keystone of the present controlled and dictated economies. France will soon find that it must either retreat to strict exchange control and economic totalitarianism, or push on farther toward a free economy. Its decision may be crucial for the world. ☼

## Significance of the Break in Prices

February 16, 1948

Last week's break in commodity prices was not mysterious. The key was wheat. In recent weeks the prospects of the world's wheat crops, at home and in Europe, had been steadily brightening, and the crops being harvested in the Argentine and in Australia had proved greater than expected. The good news was reflected in prices belatedly, because the world had formed the habit of thinking only in terms of shortages.

Nor was it mysterious that the break, when it came, should have been violent. So was the rise. When March wheat sold at \$3.15 a bushel in Chicago in mid-January, that price compared with only \$2.06 a year before. Even last week's break brought the price down only to \$2.56. The demand for wheat has always been highly inelastic. Gregory King in the seventeenth century estimated from records that a deficiency in the wheat harvest of one, two, three, four, and five tenths would raise the price three, eight, sixteen, 28 and 45 tenths respectively. Just as a world shortage (combined with our foreign-aid policy) brought a disproportionate rise in price, so the prospect of alleviation of the shortage brought a substantial fall.

For physical, financial, and psychological reasons, the break in wheat precipitated the break in other farm commodities, and even in stocks and metals. Wheat can substitute for corn as a feed. Meat is extremely sensitive to the price of feedstuffs. The meat industry, moreover, had been having its own troubles.

Retail sales had been falling off. Stocks in storage had mounted from 554,000,000 pounds a year ago to 857,000,000 on Jan. 1 last. This was brought about in large part by the Administration's predictions of a still greater meat shortage and still higher meat prices, used to bolster its demand for rationing powers. The moment a Senate subcommittee turned down the meat-rationing proposal, wholesalers started to unload. This was one more example of the way in which government controls,



or threats of them, have exactly the opposite result from the one the planners are trying to bring about.

On the very day when prices were sensationally collapsing all around him, President Truman was lecturing the White House reporters, with the help of charts, on the dangers of further “really alarming” price rises. Just as he and his planners were fearing “deflation” two years ago, he now chose to get really alarmed about inflation in the midst of the greatest postwar price decline. To add to this record of spectacular mistiming, he predicted a possible “crash.” In such a situation particularly this was reckless and irresponsible.

That the general price decline will in any way parallel the great collapse of 1920 seems quite unlikely. The fact that money and bank credit have more than tripled since the start of the war should alone prevent any such consequence. Rightly handled, the fall in the price of foods could prove wholesome. It could restore a more normal relationship to other prices. It could reduce the pressure for a third round of wage increases. It could bury the foolish proposal for a return to price fixing.

The real danger at this time, in fact, is not a continued precipitous general fall in prices. It is rather that Washington may now feel falsely assured that the inflationary threat is definitely passed, and that the politicians may once again return to their always more congenial theme that they really need to protect us from “deflation.” Even before last week’s break the political situation had become demoralized. Republicans and Democrats were competing with each other in adopting policies that could only mean further inflation. The Administration had brought in a budget of \$40,000,000,000; it was proposing more than \$9,000,000,000 for foreign aid alone; it was determined to keep down interest rates by supporting government bonds. Congress, on its side, was shoveling out still bigger grants to veterans while proposing to cut taxes \$6,500,000,000. Most of these things were being done with a bad conscience. The danger of the price fall is that it may be made the occasion for rationalizing such reckless inflationary measures as a patriotic “anti-deflation” policy. ❁

## Inconsistencies of European Aid

February 23, 1948

Nothing could be more disheartening than Secretary Marshall’s defense even at this late day of the continued dismantling of German industrial plants. Mr. Marshall himself declared only a few months ago that

the restoration of Germany, “the heart of Europe’s economic life,” was essential to European recovery. The New York Times points out that of the 918 plants scheduled for dismantling, including those of the French zone, nearly 600 are in no sense war plants, but include facilities for urgently needed farm machinery, tractors, mining machinery, and locomotives. The Dutch Government has vigorously opposed the dismantling of German plants which can be used to produce peacetime goods. The Harriman Committee declared that the situation in Western Germany, “the most disorganized area in Western Europe,” called for “radical reforms of the policies which the United States has been sponsoring.” The Herter subcommittee of the House has asked that we suspend wholesale dismantling of German industry. In his report to President Truman last March, former President Hoover declared that “the removal and destruction of plants (except direct arms plants) should stop. . . . We can keep Germany in its economic chains, but it will also keep Europe in rags.”

At best the continued dismantling and “transfer” of German plants require scarce labor and bring to an absolute halt, for the months or years that the process requires, the production of which the dismantled factories were capable. And this production is never in fact restored. Industrial machines and plants cannot be casually torn from their foundations and shipped around a continent like so many trailers. They are parts of a much greater integrated whole, vitally tied to each other, to localities, to markets, to sources of raw materials and means of transportation, and manned by trained and specialized local labor and management.

It is senseless to defend this preposterous policy of dismantling by an appeal to the Potsdam Agreement, which Russia has repeatedly violated. Even under that agreement, in fact, all dismantlings and removals were to be completed by Feb. 2 of this year. It is even more senseless to argue that we must continue this idiocy because Britain and France insist on it. It is we, we in America, who are paying the bill. It is we who are pouring hundreds of millions a year into Germany and are scheduled to pour in billions of dollars more to make up for the destruction that we ourselves help to carry on. It is we who are being asked to pour \$17,000,000,000 more of the American taxpayer’s money into Europe, largely to make up for the consequences of this destruction not merely to Germany but to the whole European Continent of which it is an inseparable economic part.

The very least we should require of the British and French Governments in return for our help is to abandon their shortsighted insistence on this policy of destruction. We cannot reestablish a solvent and productive

Europe without a solvent and productive Germany. We must put revival before reparations. And in any case we will get most reparations out of the income from current German production. Let us take a reasonable percentage of the golden eggs instead of stupidly ripping the insides out of what was once the most productive goose in Europe.

It is not only in Germany that we are shoveling out the American taxpayer's money for recovery with one hand and imposing economic strangulation with the other. That is merely our most fantastic inconsistency. We are also paying for recovery in France at the same time as the French Government itself is trying to bring about what it calls "a controlled slump." With what is left of our loan, with the resources of the International [Monetary] Fund, and with additional billions of proposed Marshall dollars, we are helping the British to maintain an artificial level for the pound and an exchange control which systematically strangle multilateral trade, free enterprise, and world recovery. American resources are not merely being thrown away. They are being used to throttle production. ⚙

## Who Advises the Advisers?

March 1, 1948

In this column of Jan. 12, concerning the 100th anniversary of the *Communist Manifesto*, incidental attention was called to the striking similarity between the theory in that document that capital accumulation, the use of machinery, *increases* "the burden of labor" and "forces wages down almost everywhere," and this sentence from the second annual report of the President's Council of Economic Advisers: "The accumulations of capital over the years have in fact involved deprivations of the rank-and-file worker."

It ought not to be necessary at this late day to point out why this Marxist doctrine is nonsensical. It is not the worker, but the capitalist, who is deprived of that much current consumption when the latter puts aside savings to invest them. And the effect of this investment, as illustrated above all in America, has been enormously to increase the quantity and improve the quality of the tools at the disposal of the worker, enormously to increase his productivity, and hence enormously to increase his wages and the goods available for all of us as consumers.

The real question we have to ask ourselves is how such an unadulterated Marxist doctrine got into the report of the Economic Advisers. This was no accidental sentence. It was part of a report which reveals

throughout an underlying distrust of precisely that "free competitive enterprise" system which the council was specifically created by law to "foster and promote."

Neither is the slurring reference in the report to "the *so-called* free market" accidental. Neither is the doctrine—also Marxist in origin—that the "cream" of American industrial production has "in large measure gone to the relatively few"; that the rest have been "subsisting on skim milk"; that "the small number of the well-to-do will not be able to absorb the possible output of consumers' goods; nor can they go on indefinitely accumulating ownership of the surplus above their consumption needs and investing it in ever-enlarging plant for future expansion of goods for some restricted part of the population." This is blandly written in an official document in the United States of 1948 which has achieved the greatest mass market in human history for food, clothing, automobiles, radios, refrigerators, and a thousand luxuries and refinements that a king could not have dreamed of owning a century ago.

This annual report of the Economic Advisers must be read in connection with the recent *Economic Report of the President*, which under the law the advisers "assist and advise" him in preparing. In neither is there any serious grappling with the central economic problem that now confronts the country—inflation. The *word*, of course, appears often enough. But nowhere is there any frank admission that the dominant cause of inflation has been the tripling of the nation's money supply—its currency and bank credit—since the outbreak of the war. The references to inflation are self-contradictory. "The nature of the inflation from which we are suffering," says the President at one point, "arises in part from the total *excess* of buying power over the available supply of goods." But a few pages farther on he demands "enough buying power to absorb the output," and declares: "For balanced expansion, our economy requires a *larger* flow of income to consumers." In other words, more inflation.

Throughout both reports the blame for almost everything that has gone wrong or could go wrong is by implication put on the American businessman. "I strongly urged businessmen," writes Mr. Truman, "to bring prices into line. . . . Business should reduce prices wherever possible." And so on. Yet he does not complain that farm prices are too high though the official statistics show that farm prices had risen in the week his report was issued 208 percent above 1939, whereas manufactured products were up only 96 percent.

The Council of Economic Advisers has dissipated whatever reputation for detachment or objectivity it may once have enjoyed. It now apparently regards its function as no better than that of providing, at the

taxpayer's expense, a "scientific" veneer for Candidate Truman's campaign arguments. ❁

## Communism and the Marshall Plan

March 8, 1948

Whenever it is shown that, unless Europe abandons inflation and collectivism, the Marshall Plan is unlikely to bring the economic revival that its supporters expect of it, one of them is sure to reply that it is not to be judged primarily as an economic but as a political plan. Politics is somewhat outside of this column's province. Yet it has always seemed to me that it is precisely as a political program that the Marshall Plan most obviously falls short. It seems to rest on the pleasant illusion that if we pour enough of the American taxpayer's money into Europe we need never make the hard diplomatic decisions, or take the unequivocal and unyielding stand, that might otherwise seem the only reply to relentless Russian aggression. It helps to support the fatal assumption that dollars can buy anything, including liberty, democracy, and peace.

Surely the fate of Czechoslovakia and Finland ought to destroy these iridescent illusions forever. It has been officially estimated that the funds we are asked to contribute under the Marshall Plan would be equivalent to 3 to 5 percent of the national production of the sixteen recipient nations. Suppose that the plan had already been in operation, that Czechoslovakia had been a beneficiary under it, and that its living standards had been raised 3 to 5 percent, or even 10 to 20 percent, above the levels that they actually reached. Does anyone seriously think that the present tragedy would have been averted? In fact, as *The New York Times* has pointed out: "It is an ironic sidelight on postwar history that Russia's latest prize was put on its feet by nearly a quarter of a billion dollars advanced by the United States." The theory that Communism takes over poverty-stricken countries, but is powerless elsewhere, no more explains the fate of Czechoslovakia than it does the Wallace vote in the Bronx.

Is it not clear at last that far sterner means than "economic aid" are needed to combat world Communism? At the very least, the fate of Czechoslovakia ought to expose forever the futility of trying to appease Stalin, of "trusting" him, or trying to "do business" with him. Yet we continue to pour goods into one end of Austria while Stalin pulls them out of the other. We are still anxiously trying to get his worthless signature to still more worthless agreements.

As for the purely economic aspects of the Marshall Plan, it is becoming increasingly evident that Europe's need is less than has been represented. While its need for foodstuffs is still serious, its new crops, expected to be far superior to last year's, will be harvested five or six months from now. As for most other needs, *The New York Times* published a dispatch from Geneva on Feb. 2 which declared: "In every case, experts [of the United Nations Economic Commission] have found that the European shortages—both over all and country by country—were much less than the governments alleged and less than expected a few months ago. . . . It has been known for a long time that several, some think most, countries in Europe now have a greater total of goods and services available for consumption and investment purposes than before the war."

Another warning comes from Roy Harrod, an economist at Oxford and author of a recent volume called "Are These Hardships Necessary?" In *The London Banker* for December he writes: "There is a fallacy which has taken root in Europe which may be very dangerous precisely because it has a strong appeal for Americans. This is that large-scale capital reconstruction is necessary for the revival of the economies. . . . We must seek to disillusion the Americans of the idea that Europe cannot survive unless she embarks upon a large-scale capital modernization program. This is likely to waste American assistance and intensify all the specific difficulties which arise from the inflationary pressure throughout Europe. It will defer recovery in the vital matters of currency reform, the restoration of circulating capital, and the revival of productive effort." ❁

## For a Customs Union

March 15, 1948

The strength of the Marshall Plan is its strength as a symbol. It is a token of America's generosity and good intentions, of our concern for the future of Europe, of our desire to halt the spread of Russian Communist aggression. The weakness of the Marshall Plan is that it is not in fact the appropriate means for securing its intended aims.

Now that the political realities are at last becoming obvious to all, it is clear that further disasters can be halted only by a union of Western Europe. Probably most Americans now favor this. But we still fail to recognize that such a union can be effective only with our own participation and unequivocal military guarantees.

Our present attitude toward collective security illustrates our national habit of smugly prescribing for



others medicine that we do not dream of taking ourselves. Another illustration is our attitude toward customs unions. We praise Benelux. We urge other free nations of Europe to form such unions. But never at any time do we seriously suggest that we ourselves join such a union.

Yet we should seriously consider joining a customs union, if only for the educational value of such an idea. From the moment we considered doing this ourselves, we would have a better understanding of the obstacles and hesitations in Europe. At home a hundred vested interests would rise in protest. And their protests could not be lightly dismissed, even if we considered the matter solely from the standpoint of the general welfare.

For under the cover of tariff protection there has grown up in this country a specific structure of production, a certain relationship of the size of each industry to every other. A customs union would mean an eventual increase in efficiency, production, and consumer welfare. But it would also mean a substantial alteration of our own structure of production, with attendant heartaches and tragedies for particular producers and workers. If we wished to soften the shock and minimize the costs of transition, the customs union could not be put into full effect except by gradual stages.

Clearly, also, the wider we attempted to make such a union, the greater would be its difficulties. The problem would be difficult enough if we proposed a union with Canada alone. It would be much more complicated if we attempted also to include Great Britain or the whole British Commonwealth. It might seem insuperable if we tried to bring in Europe or Latin America.

But all this is no reason for not making a start. For the benefits to efficiency and trade, enormous as these were, would be perhaps the least of the benefits of a customs union. They would be exceeded by the value of the economic and political by-products. A customs union would be impossible without many other reforms. It could not work unless the currencies of the member countries were freely convertible into each other in any amounts at fixed rates; and this in practice would mean that these countries must be on a free gold standard. It would not work if any member government imposed price control, or if one imposed different prices from another, or if prices in one nation differed from those in another except by costs of transportation.

This means in practice that the member countries would either have to form a complete political union or that they would have to permit free markets. And this would mean that no member government could impose the present fashionable strangling network of price controls, rationing, allocations, exchange control,

blocked currencies, bilateralism, prohibitions on capital export, import and export licensing, crushing and confiscatory taxation, constant threats of government expropriation, and all the rest. For the moment one member government adopted any part of this network, the customs union would either break down or become in fact a pretense and a fraud. A customs union is the most important single step that could be taken, apart from a military alliance, to bring that federation of free nations which is the only alternative to disaster. ❁

## The Cost of 'Soaking the Rich'

March 22, 1948

If the Republicans and Democrats in Congress were not mainly engaged in trying to outmaneuver each other for votes, and if they understood the real economic situation that confronts them, they would be debating an entirely different measure from the present tax bill. They would try to apply the ax first of all not to taxes but to expenditures. If they concluded that overall spending could not in fact be substantially cut, they would not be planning an inflationary slash in taxes of \$4,800,000,000 to \$6,500,000,000.

But they might be considering, not how many voters could be exempted completely from income taxes in order to support a short-lived illusion that the present enormous tax burden can be borne by a minority, but how far excessive tax rates on high incomes should be reduced to restore incentives to production and investment. For the funds that the present income-tax structure takes are precisely those that would have gone principally into investment—that is, into improved machines and new factories to provide that increased labor productivity which is the only permanent and continuous means of increasing wages. An even more important effect of taking so much of the taxpayer's earnings, in fact, has been to diminish or remove the incentives to bring such earnings into existence.

About a year ago in this column (April 7, 1947) I presented a table, based on income-tax returns, which brought out some striking facts. In the period between the three years 1926–28 and the year 1942, our total national income *increased* 58 percent. But total incomes over \$300,000 *fell* in that period by 77 percent. If individual incomes in each group had risen by the same percentage as the national income, total incomes over \$300,000 would have risen by a much greater percentage (because all incomes previously above \$190,000 would in 1942 have been counted among incomes over \$300,000). Yet even if the aggregate of such \$300,000



incomes had simply risen in proportion to the whole national income, the total of such incomes in 1942 would have been *seven times greater* than it actually was.

The top rate applicable to incomes over \$300,000 in 1926–28 was 25 percent. The top rate in 1942 was 88 percent. We are justified in assuming that the main cause of the shrinkage in incomes over \$300,000 was precisely this increase in the top rates. If the upper income brackets had continued to be taxed at only 25 percent, and if these incomes had increased in the aggregate no more than the national average, the yield to the Treasury would have been about 50 percent greater than it actually was at a tax rate of 88 percent.

In other words, the extremely high income-tax rates are self-defeating. Few people realize how drastically revenues from the high incomes have shrunk. Today the combined normal and surtax rate (after the 5 percent reduction) is 50 percent on all net income between \$18,000 and \$20,000. Suppose the combined rate stopped at this level, instead of mounting progressively on higher income brackets to a maximum of 86½ percent. What would be the effect on total revenues? Calculations furnished to me by the Tax Foundation indicate that the loss of revenue—if incomes above \$18,000 remained unaffected—would be about \$1,095,000,000 for the fiscal year 1948–49. This would be less than 5 percent of total individual income-tax revenues and less than 2½ percent of total budget receipts.

Obviously, however, incomes above \$18,000 would not remain unaffected by such a drastic cut in top-bracket rates. Such incomes would expand far beyond what they otherwise would be. Treasury revenues would actually be higher with a top rate of 50 percent than with a top rate of 86½ percent.

But far more important than the effect on Treasury revenues would be the effect on national welfare. The national income would be higher not because the high incomes themselves would be larger; but mainly because the lower rates would both permit and encourage high investment. It is this investment that would raise national production and real wages. In our efforts to soak the present rich we have been soaking the future poor. ❁

## Steel as a Scapegoat

March 29, 1948

The February increase in steel prices was badly timed and ineptly handled. But the most disturbing result was the nature and violence of the political reaction.

What had happened? A price rise of about 10 percent had been put into effect on less than 10 percent of the total output. The result was an average composite increase in steel prices of about 1 percent. Yet this increase touched off a deluge of denunciations and investigations.

The report of the Department of Commerce to the President helps to set the matter in its true perspective. The composite index of quoted prices for finished steel, it points out, has risen about 40 percent above the level of 1939. As compared with this, average hourly earnings of steelworkers in the same period increased 80 percent. The cost of the steel scrap that the companies must buy increased 150 percent. The cost of coking coal went up 136 percent. Where the wholesale price of steel mill products had risen in February by 43 percent above the level of 1939, all commodities at wholesale had risen 108 percent. Farm products alone, even after their break from January, had risen 179 percent.

The report points out that the rate of return on stockholders' investment in leading steel companies declined in 1947 from that of 1929 while that of all manufacturing corporations increased. "The rate of return on sales for the primary iron and steel producers was lower in 1947 than in the '20s generally and was only one-half of the 1929 ratio. It was also somewhat below the years 1937, 1940, and 1941." Moreover: "The retained earnings of the steel producers have been below the amount necessary to cover their net plant and equipment expenditures."

The Council of Economic Advisers, on the other hand, seems determined to make the steel industry a scapegoat. As a result its report is full of inconsistencies and non sequiturs. It admits the industry's "moderation in price making," but blames it for adding to "inflationary pressures." It admits that "our rate of economic growth will suffer if the steel industry does not find it possible or profitable to improve and expand with the rest of the economy." But the effort to modernize and expand the steel industry, it fears, would increase inflation; therefore, one gathers, the industry shouldn't modernize or expand now and shouldn't be allowed to earn enough now to modernize and expand later.

"It is futile," the council continues, "for the steel industry to issue a call for restraint in the matter of wage negotiations at the same time that it is itself raising prices." This seems a tip-off to the steel unions that the council would regard them as justified in asking for a further wage increase, particularly as it neglects to reiterate that even when we include the recent 1½ percent steel price rise, steel wages have already risen since 1939 twice as much as steel prices.

The political reaction to the steel price rise represents, with a few honorable exceptions, the triumph of demagoguery over objective analysis. Though wages and wheat have risen far more than steel, politicians still talk up wages and wheat while denouncing the steel industry for an awkward effort to catch up. Higher wages and higher farm income are treated as virtuous and welcome, but higher profits as a disaster and a sin. There is little recognition of the function of profits both as an incentive to production and a source of capital expansion. Industrial prices are discussed as if businessmen fixed them arbitrarily, depending upon how much they felt like restraining their greed. Inflation is blamed on private industry. The report of the Economic Advisers does not even mention the basic cause of inflation, which is the tripling of the money supply since the outbreak of war and the government's continued cheap-money policy.

The council distrusts the free market. It wants a return of price control—on the assumption, no doubt, that if the economic system were put completely in the hands of the bureaucrats everything would be as perfect here as it is in England. ☼

## Fallacies of the Third Round

April 5, 1948

Demands for a third round of wage increases are based on the argument that the rise in living costs has outstripped the rise in wages. Official figures show, on the contrary, that between 1939 and February of this year average hourly earnings of manufacturing workers increased 104 percent, and average weekly earnings 119 percent, while the cost of living went up only 69 percent. Only by selecting as a base of comparison June 1946, when the relationship of wages to the cost-of-living index was most favorable, can the union leaders show a slightly greater rise in living costs than in wages. And we must remember even here that the cost-of-living index under price control was largely fictional. It made no adequate allowance for black markets, unobtainable goods, and deterioration in quality.

It is, moreover, precisely the labor unions already best off that now take the lead in demanding further gains. Average weekly earnings in 25 manufacturing industries in December were \$52.74. But in the iron and steel industry they were \$58.20; in meat packing, \$61.57; in the printing trades, \$63.57; in the automobile industry, \$65.47; in anthracite mining, \$67.42, and in bituminous-coal mining, \$75.22. Incidentally, weekly

wages in the soft-coal fields were 211 percent above their 1939 level.

Such comparisons call attention to the fallacy of lump thinking about wages. That fallacy is made graphically clear in a study of the "Behavior of Wages" just completed by Jules Backman and M.R. Gainsbrugh for the National Industrial Conference Board. This study reveals not only that it is undesirable to try to impose blanket wage increases on the American economy, but that, contrary to common belief, we have never actually had such uniform increases, even in the recent past. It is widely believed that the first round of postwar wage increases was a uniform advance of 18½ cents an hour. A survey of 153 industries, however, in the period from September 1945 to February 1947, shows advances ranging from only 5 cents an hour in some industries to 30 cents in others. Out of 15,800,000 workers, only 3,700,000, in fact, were in industries which received average increases ranging between 17.5 cents and 20 cents an hour. Some 6,000,000 workers received less and some 6,000,000 received more.

From 1929 to 1939, to cite another illustration, 25 manufacturing industries show an average increase of 22 percent in hourly earnings. But the average rise was different in every one of these 25 industries, ranging from 3.6 percent in the lowest to 37.1 percent in the highest. The diversity is similar no matter what period we take.

We must remember, finally, that the wage-increase figure for each industry is itself an average. It conceals the diversity of increases among individual firms in that industry. The average increase in each firm, again, conceals the diversity among individual wage increases.

Today efforts are being made everywhere to impose an arbitrary uniformity on wages. All such efforts impede the functioning of a free economy. When a union imposes uniform wages within a single firm, regardless of differences between individual workers in merit, skill and output, it reduces or destroys individual incentives to improvement and production. When industrywide unions impose uniform national wage scales they retard or prevent the growth of industry in the South and in small towns. When government seeks to impose a national uniform increase in wages, it destroys the free market mechanism of fluid adjustment of prices, wages, and synchronized production. It prevents expanding industries from attracting workers by offering relatively higher wages while it forces violent adjustments on less profitable industries.

An attempt to impose a blanket third round of wage increases now would bring further distortions in our economy. Unless it were offset by still more monetary

inflation it would mean dangerously excessive production costs which would either wipe out profit margins or force up individual prices to levels that would contract demand. In either case the result would be unemployment. ☸

## To Improve the Taft-Hartley Law

April 12, 1948

In spite of the persistent smear campaign against the Taft-Hartley Act, experience has shown it to be incomparably superior to the Wagner Act that it supplanted. Strikes have been fewer, most union demands more moderate, and union leaders less highhanded. The improvement is so great that it takes the appearance of some new crisis, like the walkout in the coal fields, to remind us how defective our labor legislation still remains. Yet the way toward labor peace is not through more laws and more government coercions, but through more freedom.

The Taft-Hartley Act is after all only an amendment to the Wagner Act. It retains what was centrally unsound in the original law. It keeps nearly all the Wagner Act's legal compulsions on employers, but tries to balance them by equivalent legal compulsions on unions. When this fails to bring the results desired, sponsors of the Taft-Hartley Act can only think of additional compulsions. Thus Congressman Hartley himself wants to make violence in labor strikes a Federal offense. It would be difficult to imagine a worse remedy. It is clearly unconstitutional. It would usurp the police functions of the states and cities.

It is clear, on the other hand, that the continued arrogance of John L. Lewis, his continued power, which he seems eager to demonstrate afresh each year, to bring the country's industry to a slowdown or a halt by merely knitting his bushy brows, is not a power that he possesses in spite of existing Federal law but because of it. John L. Lewis is a Frankenstein monster blown up to his present size by Federal protection. He was not always so big. The Lewis coal strikes of 1927 and 1932 collapsed completely. The result of Lewis's recklessness in those years was to leave his mine union shattered and prostrate—until he and it were put back on their feet, first by the NRA and then by the Wagner Act of 1935.

The mighty monopolistic weapon which the Wagner-Taft-Hartley Act has placed in the hands of the Lewises, Murrays, Reuthers, and Petrillos is the legal compulsion on the employer to recognize and

bargain with huge industrywide unions no matter how contemptuous their conduct or fantastic their demands. All that is needed is to withdraw this compulsion. This would not illegalize industrywide or nationwide unions. Such unions would then occupy the same status under the law that foremen's unions now occupy under the Taft-Hartley Act. They could continue to exist, but the employer would not be *legally* compelled to recognize or bargain with them. Section 9 (b) of the existing law provides that the labor board "shall decide in each case whether . . . the [employee] unit appropriate for the purposes of collective bargaining shall be the employer unit, craft unit, plant unit, or subdivision thereof." The mere removal of the two words "craft unit" would not illegalize such units; it would merely take from the board its power to force employers to recognize and bargain with such industrywide units.

Two other changes in the law are necessary. One would remove the legal requirement on the employer to continue to recognize or bargain with a union that resorted to mass picketing, threats, and violence. The Federal authorities should make no effort to stop these. That should be left wholly to the local police. But at least the Federal government should remove the implied sanction it now gives to such tactics when it continues to make it obligatory on an employer to bargain with unions that resort to them.

Finally, the compulsion should be removed from the Wagner-Taft-Hartley law which in effect prevents employers from discharging strikers. The Federal government should not illegalize strikes; but neither should it encourage them by removing the risks involved.

If these coercions on employers were modified or removed, the Taft-Hartley Act could also modify or remove the ill-advised coercions it has imposed on unions—in connection, for example with political expenditures and 80-day waiting periods. In spite of the present Federal injunction against John L. Lewis, it is doubtful whether most of these coercions can be enforced. ☸

## Britain's Collectivism vs. ERP

April 19, 1948

Two days after the Marshall Plan was safely enacted the Economic Commission for Europe released "the most complete and thorough study" on European recovery. This report, according to a Geneva dispatch to *The New York Times*, "contains the facts and analyses that Congress wanted before acting on ERP but could not get because they did not exist. It contains powerful



ammunition for those who believe that many of the troubles of Western Europe are due to the pursuit by governments of domestic policies encouraging a continuation of the dollar shortage . . . rather than industrial weakness or even losses and changes due to war.”

The report shows that total commodities available for home use in Europe as a whole, excluding Germany, had reached 96 percent of the prewar level on a per capita basis by 1947. Six European countries had more goods per capita than in 1938. All this did not prevent the cartoonists who were supporting the Marshall Plan here from invariably picturing present-day Europe as a starving old woman in rags, waiting to be rescued from death while pompous congressmen had the callousness to debate the problem.

“With the exception of Britain’s, every [European] country’s foreign balance of payments has been moving steadily away from equilibrium largely as a result, the survey finds, of continuous inflationary pressure combined with artificially overvalued exchange rates.” Even the exception of Great Britain here hardly seems to harmonize with the recent statement of *The London Economist* that the British economy “is now using up its last reserves.”

Yet what are the British doing—or being allowed to do—to help themselves? In Sir Stafford Cripps’s budget message we have part of the answer. It is a new graduated tax upon the portion of a man’s income derived from investments. For example, a man with an income of £50,000, all derived from investments (whether in real estate, stocks, or even government securities), would pay a special tax of £24,000 in addition to his ordinary income tax of £45,000—making a total tax of £69,000 or £19,000 more than his total income.

Such a tax will destroy capital values and further disorganize British production. It will not only prevent saving and investment but force dissaving and disinvestment. In the long run this must reduce productivity and real wages. It seems highly unlikely that the amount of American capital which we can contribute under the Marshall Plan will be enough to offset the amount of home private capital that the British Government is destroying.

Meanwhile, even if Britain’s production should recover in spite of everything its government is doing to prevent it, this would not necessarily solve the immediate crisis, which consists in the gap in its international balance of payments. The British bureaucracy can see this problem, as it can see every other economic problem, only in collectivist terms. It has completely forgotten that individual consumers and producers, acting in accordance with free market

forces, automatically solved in the past the kind of problems its own policies are now creating. It thinks bureaucrats must set “targets” for the output, import, and export of everything.

The British trade deficit is certain to be chronic as long as the government maintains exchange control with an overvalued pound. The mere attempt to offset the distortions which such exchange control brings about must lead to increasing regimentation of the rest of British economic life. Under exchange control a free economy is impossible. The only solution is to let the pound be freely bought and sold at the prices established in a free market. But this is the one solution which the Socialist doctrinaires now in control of the British economy are determined never to permit. Meanwhile our government has virtually committed itself to support this Schachtian device for four years, and to drain American capitalism for funds for British zealots to use in destroying capitalism and production in Britain. ❁

## An Anti-Inflation Program

April 26, 1948

Marriner Eccles, making his exit as spokesman for the Federal Reserve Board, recommended to the Joint Committee on the Economic Report an increase in reserve requirements for Federal Reserve member banks and the extension of reserve requirements even to nonmember banks. Senator Taft, the committee chairman, told reporters that added authority of this sort was not likely at this session of Congress.

Inaction on this subject, however, would be a mistake not only from the national standpoint, but even from the standpoint of Republican prospects in November. Unless the Republican majority in Congress itself frames and passes a positive anti-inflation program, its criticisms of President Truman’s policies will seem very unconvincing by election day if inflation resumes its progress in the next six months.

This does not mean that such a program should take the precise form that Mr. Eccles recommends. His particular recommendations are too vulnerable. But he is right on his central point, which is that inflation is primarily a consequence of money and credit expansion. A Congressional anti-inflation program should include four main provisions:

1—It should at least authorize the Federal Reserve Board, if it does not direct it, to restore the former legal requirements for 35 and 40 percent reserves in



the Federal Reserve Banks instead of the present 25 percent reserve requirement.

2—It should authorize the Federal Reserve Board, as Mr. Eccles suggests, to increase the reserve ratios of member banks. Present maximum legal reserve requirements are 26 percent for member banks in New York and Chicago, 20 percent in other reserve city banks, and 14 percent in so-called country banks. Mr. Eccles suggests that these be raised to about 35, 30, and 25 percent respectively. But if something like this is authorized, Congress should stipulate that the board cannot order any increase in member-bank reserve ratios until it has *first* restored the previous Federal Reserve Bank ratios. Only such a provision can halt the continuous efforts of Federal Reserve officials to restrict the lending powers of the member banks at the same time as they increase the far more inflationary lending powers of the Federal Reserve System itself.

3—A comprehensive program should terminate some inflationary measures still on the books. It should repeal the Thomas greenback amendment. It should repeal sections 8 and 9 of the Gold Reserve Act of 1934, which gave the Secretary of the Treasury the power, with the approval of the President, to purchase and sell gold “at such rates and upon such terms and conditions as he may deem most advantageous to the public interest.” It might tidy up our present hodgepodge currency system by repealing the Silver Purchase Act of 1934, and by providing for the prompt retirement of Federal Reserve Bank notes and the gradual retirement of national bank notes and United States greenbacks.

4—Most important of all, an anti-inflation measure should contain a general declaration of policy on the part of Congress. This should direct the Federal Reserve Board to follow policies designed to bring a halt to any further inflationary expansion of money and bank credit. The board should be instructed to do this with care, to avoid precipitating any sudden or severe contraction of credit that could have serious deflationary consequences.

Only by such a comprehensive measure (combined with sounder expenditure and tax policies) can Congress prevent the present inflation from going farther. Only by such a measure can it take the offensive in the battle against inflation and center public attention on the fact that it is, above all, government fiscal and credit policy that creates inflation. Otherwise President Truman will continue inflationary monetary policies while declaring, as in his speech to the American Society of Newspaper Editors, that the only cure for inflation is to give him power to fix prices. ❁

## How Not to Cure Inflation

May 3, 1948

Last week, suggesting a positive anti-inflation program, I referred to President Truman's April 17 speech before the American Society of Newspaper Editors in Washington. This speech so gravely misconceives the causes of inflation and the remedies for it as to call for some line-by-line comment.

*“I cannot sit by silently while inflation continues to creep up on the American people.”* It is precisely the fiscal and credit policies his own Administration has followed that have caused the inflation he wishes to combat.

*“I have repeatedly urged businessmen to exercise voluntary restraint in setting prices.”* Once more the effort to blame business. High prices are the consequence of inflation, not the cause.

*“By last fall, it had become clear that we could not place our main reliance on voluntary methods.”* The totalitarian touch: lack of faith in freedom; government coercion as the sovereign cure. Secretary of Agriculture Anderson assured the House Banking Committee on Dec. 3 that without price controls meat might reach “fantastic prices” by April or May. Meat prices on the hoof are now lower than when his prediction was made.

*“The total demand for goods is still outrunning production.”* Why, with production at record levels? Because “demand” means monetary demand. Whose policies have been responsible for the added money and bank credit?

*“Some key prices have been increased, unwisely and unnecessarily. The outstanding case was, of course, the increase in some important steel prices.”* A discredited myth. The February increase (averaging about 1 percent) left steel prices—as the report of the President's Department of Commerce showed—43 percent above the 1939 level, compared with an increase of 80 percent in hourly steel wages, of 108 percent in all wholesale commodities, and of 179 percent in farm products. Last week's price cuts by United States Steel virtually wiped out its earlier price increases.

*“In addition to these price increases, inflation has been encouraged by some unnecessary interruptions to production. The outstanding example, of course, was the work stoppage in the coal industry.”* Mr. Truman neglects to add that he was all in favor of the Wagner Act, which gave John L. Lewis power to stop the coal industry; and that he denounced and vetoed the Taft-Hartley amendments, which enabled the government to get production going again.

*“Another new factor making for inflation is the bill recently enacted by the Congress reducing government*

revenues by \$5,000,000,000." A valid point. But Mr. Truman neglected to remind his listeners that he himself favored a tax-reduction bill more cynically political than the one passed over his veto.

[Both foreign aid and increased national defense] "can add to inflation." Correct.

"The anti-inflation program I recommended to the Congress last November should be enacted at once. . . . It includes measures to reduce the excessive amounts of money and credit which are lifting prices." It includes no measure to stop the government's cheap money policy that feeds inflation; no measure to restore the former legal reserve ratio of the Federal Reserve Banks, or to repeal old inflationary legislation.

"It includes measures to deal directly with specific high prices . . . designed to hold prices down while keeping production up." Holding prices down by coercion and ukase has proved to be the surest of all ways of holding down production. "Selective" price fixing reduces most of the production of precisely the goods that are most wanted.

It is disheartening that the President has learned nothing not only from our own postwar experience in price fixing, but from the appalling consequences of existing price control in Europe. The most important thing America can do today is to continue to demonstrate to the world the enormous production possible through free prices and free enterprise. We must not cripple ourselves by imitating the very controls that have forced Europe to turn to us for help. ❀

## The Fallacy of Exchange Control

May 10, 1948

*Nobody can for a moment doubt that it is far from the intention of the leading democratic countries to consider as a permanent arrangement the exchange control which, contrary to the fundamental character of their peacetime economy, they have introduced today. To do so in peacetime would in fact carry their political and economic life irresistibly down the slippery slope of collectivist authoritarian totalitarianism.*

These words were written in wartime, in 1942, by the European economist Wilhelm Röpke, in his book *International Economic Disintegration*. His faith in the strength of the liberal tradition proved in this respect sadly misplaced. Surely the British, for example, must believe that they are getting something very substantial in return for the coercion of both producers and consumers, and the sacrifices of economic freedom, that

exchange control involves. Are the supposed gains in fact delusive?

At the official rate of \$4.03, the pound today is overvalued. This was shown by the quick collapse of sterling convertibility (at \$4.03) last summer. Convertibility will continue to be a one-way street as long as British bureaucracy insists that sterling must be bought and sold above the value that the importers, exporters, bankers, and traders of the world in fact attach to it. Wherever in the world black or free markets appear they show rates for pound notes in the neighborhood of \$2.60 and for the transferable sterling in the neighborhood of \$3.25.

The British bureaucrats believe that they cannot afford to allow a free market rate for the pound. It would, they say, increase the cost of imports. It would certainly do so in terms of *pounds* but not of dollars. And what they complain of is not a pound shortage but a dollar shortage. If the pound on a free market sold as low as \$3, then a million bushels of wheat would cost British consumers, say, £800,000 instead of only £600,000 as at present. But it would still cost Britain, as before, only \$2,400,000 of its dollar reserves.

The British bureaucrats argue, on the export side, that if they let the pound fall to its market level Britain would get less for its exports. This is an outright fallacy. What the British exporter gets (or in a free system would get) for his exports to our market, for example, is determined by the price he can get for them in dollars in America. In the long run this has nothing to do with the rate for the pound. If a British exporter sells 2,400,000 yards of cloth in New York at \$1 a yard, he gets \$2,400,000 for it. If this exporter in a free exchange market got only \$3 instead of \$4 for each pound, he would quickly compensate for this by an exactly proportionate increase in the number of pounds he got for the same volume of exports. Where he now, at \$4, gets only £600,000 for his 2,400,000 yards of cloth, he would at \$3 get £800,000 for it.

So keeping the pound coercively at \$4 helps Britain not at all in solving its dollar problem. On the contrary, it is the very thing that creates the problem. For the relative cheapness with which British citizens can buy American imports in terms of their own currency unduly encourages imports. This encouragement must then be offset by discriminatory bureaucratic prohibitions against the import of specific articles.

The overvalued pound, on the other hand, discourages and reduces exports. It wipes out the price premium that the British manufacturer might otherwise have had as an incentive to export instead of selling at home. It either puts a price premium on *domestic* sales

or compels him to overprice his exports (in terms of foreign currencies) and hence to lose potential sales in foreign markets and end up with fewer dollars.

When such consequences are pointed out, the British bureaucrats reply that as a matter of fact British manufacturers are today selling abroad all that they are physically able to produce for export. But they complain in the very next breath that their foreign-trade position is desperate. On closer inspection they will find that this is largely because, and not in spite of, exchange control. ❁

## Rewarding Railway Strikers

May 17, 1948

For many years the Railway Labor Act of 1926 was popularly regarded as a model labor law. It had bought peace and prevented strikes. What the general public did not see was that this peace had been bought at an exorbitant price, not merely in open wage increases, but in government-sponsored growth of the most fantastic set of featherbed rules to be found anywhere.

Beginning seven years ago the elaborate machinery of mediation, arbitration, and "fact finding" in the act was repudiated by the very railway labor unions in whose interest it had been set up. First President Roosevelt and then President Truman conspired to undermine the prestige of that machinery and to render it useless.

The crucial precedent was established in 1941. The railway unions then rejected the pay-increase recommendations of President Roosevelt's emergency fact-finding board. In an editorial in *The New York Times*, the present writer posed the question: "If either the managements or the President under the threat of a strike grant the railway workers more than the President's fact-finding board recommended, what will be the use of such boards in future?" President Roosevelt was at least aware of this dilemma and made a technical effort to escape it by referring the question to the board a second time. Ostensibly it was asked to reconsider its decision because of "new evidence," but everyone knew that in reality the most important piece of new evidence was that the unions had rejected the first award of the board and had threatened to strike. As the present writer commented after the decision had been changed upward:

"Government boards have once more been put on notice that if they want to keep the appearance of prestige, they had better bring in the first time a decision that the union leaders are going to like. . . .

"This whole incident has proved once again that not only as against employers but as against governmental recommendations it is not a disadvantage for a union to threaten to strike, but an advantage. The railway unions were not penalized for threatening to hold up the national defense; they profited by that threat."

The pattern was repeated with minor variations in 1943. This time, confronted with another strike threat, President Roosevelt did not even bother to resort to the fiction of "reconsideration" by the board. He simply by-passed and outbid all his own officials by personally granting the railway unions bigger increases than either his own emergency board or his own Stabilization Administrator had offered them. He thereby destroyed the authority of his own appointees and encouraged the unions to ignore them altogether in the future.

As a result of such government surrenders, the railway unions really began to feel their oats. In 1946 they not only rejected as a matter of course the decision of President Truman's fact-finding board, but they even rejected the President's personal offer of better terms. The final outcome of that episode was commonly described at the time as a "defeat" for the striking unions. But the union members themselves noticed that they were better off as a result of their strike and defiance than they would have been without it.

So here we are at the 1948 pattern. President Truman's emergency board, after hearing evidence for 33 days, has recommended a wage increase of 15½ cents an hour. Three railway unions—the engineers, firemen, and switchmen—refused to accept this decision and voted to strike.

The only solution open to the President, if he wished to retain the Railway Labor Act, was to warn these unions that the government had no further concession to make; that if they struck railway management would be free to discharge them and to hire other permanent workers to take their place; and that essential trains would be kept running. The melodramatic, unnecessary, and dangerous device of government seizure, so often regarded as a "strong" action, has usually served in the past merely as a cloak for government surrender to union demands. ❁

## Price Fixing into Famine

May 24, 1948

The principal cause of the present world economic crisis, with its chronic shortages of food, coal, steel, and dollars, has not been the physical destruction of the war, great as that was, but the worldwide mania for



government economic controls. Striking confirmation of this in the realm of food appears in a forthcoming article by three agricultural economists (F.A. Pearson, W.I. Myers, and E.E. Vial) in the periodical *Farm Economics* published at Cornell University. The facts it presents speak for themselves:

The Argentine Government sells wheat for export at \$5 or more a bushel in United States dollars. It pays the Argentine farmer the equivalent of \$1.59 to \$1.83 a bushel and pockets the difference. The Canadian farmer is allowed only \$1.35 a bushel plus a "participation certificate" worth about 20 cents. The United States farmer gets a free market price of about \$2.80 a bushel. (Prices cited are those prevailing when the article was written.)

What has been the consequence of these policies? In spite of the desperate world shortage of wheat, the 1947 acreage of wheat in Argentina was 22 percent *below* the 1935–39 level. In Canada the 1947 acreage of wheat was also 7 percent *below* prewar. Neither decrease can be blamed on the weather: in both countries the acreage for the two preceding years was also below the prewar level. In the United States, on the other hand, wheat acreage expanded as prices rose, and in 1947 was 29 percent *above* the prewar level. In brief, farmers in this hemisphere responded to price incentives or their absence rather than to verbal exhortations. The farmers obliged to take low wheat prices contracted their acreage; the farmers permitted high prices expanded it.

The article finds it "difficult to generalize about Europe with its divergent price policies, varying degrees of devastation, etc." The only European country it specifically cites is bizonal Germany, in which the 1947 acreage of food grains was 20 percent below prewar level. I shall therefore add some supplementary material from other sources.

It is the official French doctrine that the disastrous shrinkage of the French wheat crop last year was caused solely by unprecedented frost and drought. Bad weather undoubtedly accounts for a great deal. But comparative statistics are instructive. Whereas in 1947 the French acreage harvested of the bread crops wheat and rye was 37 percent below average prewar levels, the acreage of the feed grains (barley, oats, corn, etc.) was only 14 percent below. It is hard to escape the suspicion that this contrast has something to do with the fact, pointed out by the French economist Jacques Rueff in the April issue of *Foreign Affairs*, that the official price of wheat in France is fixed relatively lower than that for other cereals, and that stricter measures are adopted to make the official price respected. In contrast to the government-controlled price of wheat in Canada, for example,

the Winnipeg price of rye is free. On Dec. 30, 1947, rye was \$4.05 a bushel, compared with the controlled wheat price of about \$1.55. Result: The 1947 acreage of rye was 42 percent *above* the prewar level, while wheat acreage was 7 percent *below*.

Finally, as the economist Wilhelm Röpke writes from Switzerland in the April 29 issue of *The Commercial and Financial Chronicle*: In Germany "a lady's hat may be freely sold at the equivalent of more than one ton of wheat. We can hardly expect the German farmer to sell his products forever at official prices which not only mean that he is practically giving them away, but also that he cannot go on producing them since he cannot buy with his paper money what he needs on his farm."

In brief, the fantastic collectivist controls imposed by our own American bureaucracy in Germany have put a tremendous premium on *not* producing food. And in spite of its appalling results in bringing world food scarcity, President Truman insists on a restoration of price control *here*. That would complete the disaster. ☛

## The Incubus of Exchange Control

May 31, 1948

The National Advisory Council, composed of Cabinet-level officials headed by Secretary Snyder, reminds Marshall-Plan countries that their exchange rates "will require adjustment." Paul Hoffman, head of the ECA, thinks it "quite obvious that there should be more realistic rates of exchange."

It is gratifying to have at last this official recognition of exchange realities, even though the NAC still fails to draw some of the most important logical conclusions from this recognition.

The British pound is the key example. It was pointed out in this column on May 10 how exchange control with an overvalued pound systematically encourages imports, discourages exports, and brings a chronic trade deficit, which the United States is then called upon to make up. If the pound were allowed to decline to its free-market value the result, it is true, would be a substantial increase in Britain's internal price level. For in terms of pounds imports would cost more. And British consumers (in the absence of watertight allocations) would be forced to pay higher prices to hold their share of goods at home against the increased price in pounds obtainable for exports.

But the only way that Britain in the long run could avoid this result is by an internal deflation. This could be brought about by slashing government expenditures, particularly on capital projects and on food subsidies,



by increasing the purchase tax, by abandoning the infra-low interest rate policy, and by warning British labor that it must keep its wage rates low enough to meet world competition at a \$4 rate for sterling. One has merely to cite these conditions to recognize how improbable they are politically under the present Labor government.

The British Government, in short, has a choice of free foreign-exchange markets, of official devaluation, or of rigorous internal deflation: and it is unwilling to embrace any one. This “forces” it to impose direct import controls. But as the Canadian economist Donald B. Marsh points out, it has “a basic predilection for controls combined with a policy that, by deepening the crisis, makes the removal of controls unthinkable.” As he adds: “In a country as dependent as Great Britain on external trade, exchange control provides the ultimate in governmental control of private business. Whether exercised or not, the government’s power under exchange control is literally the power of life and death over firms and industries dependent upon imports.”

The British bureaucrats are convinced that the only cure for the trade deficit is a great *overall* increase in British production. All that is really needed, however, is a change in the internal structure of consumption and production sufficient to correct the trade balance. This task is not herculean. What is involved is a total annual trade deficit officially estimated at £250,000,000. This is less than 3 percent of Britain’s present national income. It could be corrected either by raising British production 3 percent (less than the actual increase of 1947 over 1946) or by lowering British consumption 3 percent.

But analysis shows that instead of devoting the resources released by the cessation of the war to export production, these have been chiefly reabsorbed by other activities. And it is government controls that have prevented readjustment. Only when free exchange rates and free prices are reestablished will imports and domestic output readjust themselves to the proportions necessary to cure the trade deficit.

As long as other currencies also remain overvalued and inconvertible, it is true, the British cannot correct their balance of payments by sales to “soft-currency areas.” But British and above all American leadership could get the leading countries of the world simultaneously to abandon the whole vicious Schachtian network of exchange control. It is fantastic for America to be draining its resources in order to subsidize and prolong a totalitarian device that disintegrates and strangles international trade, makes free enterprise impossible,

retards European recovery, and intensifies and perpetuates the very “dollar shortage” that it pretends to cure. ☸

## The GM Wage Pattern

June 7, 1948

The General Motors wage settlement last week transformed the country’s business outlook over night. It marked the formal opening of the third round. Unions everywhere will seize upon the precedent.

The GM settlement will be all the more influential because of a certain *prima-facie* reasonableness. In addition to providing an initial increase of 11 cents an hour (8 cents for a “cost-of-living adjustment” and 3 cents for an “annual improvement factor”), it provides for quarterly adjustments for further changes in the official government consumers’ price index and for an additional 3 cents an hour as an “annual improvement” factor.

On closer examination, however, the flexible features of the GM settlement are found to be virtually all one way. No matter how much cost of living should fall, the downward adjustment on that account cannot exceed 5 cents an hour. But there is no corresponding upward limit if the cost of living should rise. The “adjustment” has a floor but no ceiling. And the 3-cents-an-hour “annual improvement” increase is to be granted whether or not man-hour productivity is in fact increased correspondingly.

General Motors, the biggest industrial corporation in the country, can presumably afford this type of wage contract. But American industry in general can certainly not afford to begin with still another “cost-of-living” increase. Official statistics already show, in fact, that whereas the consumers’ price index has increased 69 percent compared with the 1935–39 level, average hourly industrial earnings have increased 115 percent. On this prewar base, therefore, the first “cost-of-living” adjustment, instead of being 8 cents an hour upward, would have to be an average of 27 cents an hour downward!

We must remember, again, that the consumers’ price index represents an *average* of many different prices. If companies whose products have risen in price much less than the average were nonetheless compelled to pay wage increases equal to the average, they would either be forced out of business or forced to raise prices. If the price index were thus forced up, this would of course in turn require still further upward cost-of-living wage adjustments. And the uniform application of the

GM cost-of-living formula would also prevent the kind of constantly changing variations among different wage rates that are necessary to draw workers into growing industries and out of declining industries.

The same sort of consequences would follow any automatic, uniform “annual-improvement” wage increases. Owing to new machinery and methods, the productivity of the average American worker has in fact in recent times been increasing at the rate of 2 to 2½ percent a year. But here again it must be kept in mind that this is an *average*, both of many years and of many different industries. An investigation by the United States Bureau of Labor Statistics shows that the physical output per man-hour *dropped* in the boot and shoe industry from an index number of 113.2 in 1941 to 105.9 in 1944, in the cement industry from 108.3 in 1941 to 83.8 in 1944, and in nonferrous metal refining from 108 in 1940 to 95.9 in 1945. How can industries or firms in which man-hour productivity is actually declining afford to pay automatic “annual improvement” increases?

Finally, it must be remembered that this long-run average increase in labor productivity has not been automatic. Its continuance cannot be taken for granted. It has taken place in America because capital accumulation has been steadily raising man-hour productivity on the average by putting more or better tools into the hands of the workers. But this capital accumulation has been made possible by sufficiently high profits to enable corporations to plow new capital back into plant expansion. If corporate profit margins are reduced by taxation or excessive wage increases to where they are dangerously narrow, “annual improvement” increases, even on the average, will no longer be possible. Labor will then find itself moving into lower instead of higher living standards. ❁

## Who Started the Third Round?

June 14, 1948

As pointed out in this column last week, any widespread application of the General Motors wage-settlement formula would put further strains on our economy. It would either force the creation of enough additional inflationary bank credit to meet higher payrolls and support higher prices, or it would result in unemployment.

A third round of wage increases being so harmful to the economy and to the long-run interests of labor itself, who started it? Other employers, big and small, privately blame General Motors for capitulating to the union demands. But the causation must be traced

farther back. Who is it, or what is it, that made it almost inevitable from the start that employers would capitulate to a third round?

Part of the answer can be found in the White House. President Truman and his advisers always affect to deplore something they call “inflation.” But this always turns out to be primarily an objection to high industrial prices. They ignore the basic fiscal and monetary causes of inflation, for which they themselves are largely responsible, and the high prices of farm products that their own policies have helped to bring about. And they have never been willing to put wages in the same category as prices. Prices are to be held down, controlled, frozen, rolled back; but in wages it appears that there are always “inequities” still to be adjusted—of course never by lowering any wage, but always by raising the wages that are still “submarginal” or have not yet “caught up.”

Mr. Truman has again and again intervened to push up wage rates. He did so in late 1945 and early 1946 by imposing a thinly disguised form of unilateral compulsory arbitration when he appointed a “fact-finding” board that in effect ordered General Motors to pay an increase of 19½ cents an hour. Later, without even waiting for a report from his own fact-finding board, he rewarded Philip Murray for tying up the nation’s steel industry by recommending an increase of 18½ cents an hour in wages in that industry.

Then he set aside the 16-cent-an-hour increase for railway engineers and trainmen, recommended after a month’s study by his own fact-finding board, and awarded them 18½ cents. When John L. Lewis scorned even an 18½-cent-an-hour increase and struck, Mr. Truman stepped in, seized the coal mines, and made the government itself grant wage increases, royalty payments, and other benefits to Mr. Lewis’s union far in excess of Mr. Truman’s own previously announced “wage line.”

Mr. Truman is still not cured. On the very day that General Motors made public its latest wage boost, he again urged Congress to raise legal minimum wages from 40 to 75 cents an hour. This would be an increase of 87½ percent. And union insistence on maintenance of existing wage differentials would put further upward pressure on wages all along the line. Congress, however, must share responsibility for inflationary wages. For the Wagner Act, though improved by the Taft-Hartley amendments, is still retained in essence. It builds up and greatly strengthens industrywide unions. It compels employers to bargain with the leaders of those unions, no matter how extravagant their demands. If those unions resort to mass picketing, intimidation, or

violence, the Wagner-Taft-Hartley act takes no cognizance of it. Yet the act abridges the employer's right to discharge or replace strikers, to bargain with individuals or with other union representatives, or to exercise other previous rights of management.

The act, in brief, takes the risks out of strikes. The Administration and Congress endow great private organizations with the power at any time to bring the nation's industry to a halt, and then express surprise and regret that these private organizations use this power not primarily for the public weal but for their own private ends. We set up a legal mechanism which makes employers virtually powerless to refuse increased wage demands, and then see no connection between this and the fact that strong unions then impose wage demands so great as to imperil the whole economy. ❁

## How to Combat Communism

June 21, 1948

Candidate Truman, in the course of his barnstorming campaign for the Democratic nomination, adopted and elaborated one of the favorite clichés of the Wallace-ites and muddleheaded "liberals":

"As far as the United States is concerned, the menace of Communism is not the activities of a few foreign agents or the political activities of a few isolated individuals. The menace of Communism lies primarily in those areas of American life where the promise of democracy remains unfulfilled.

"If some of our people are living in slum housing and nothing is done about it, that is an invitation to Communism. If some of our people are forced to work at substandard wages and nothing is done about it, that is an invitation to Communism. If some of our people are arbitrarily denied the right to vote or deprived of other basic rights and nothing is done about it, that is an invitation to Communism. . . . And finally, if high prices are depriving some of our people of the necessities of life and nothing is done about it, that is an invitation to Communism. . . . Let us adopt legislation that will provide our citizens with the homes they need."

If it is bad economic conditions that are primarily responsible for the spread of the Communist ideology, how does it happen that this ideology has reached its highest influence in the United States precisely at a time when its people enjoy the highest standard of living ever reached by any nation in the history of mankind?

Let us compare living standards in America, which Mr. Truman still seems to find so deplorable, and living standards in Communist Russia. Has Mr. Truman ever read the report of the Department of Labor, showing that the average worker in Russia is about *one-tenth* as well off as the American worker in terms of what his wages will buy? Will we be inviting Communism until we produce a living standard here eleven times as high as Russia's instead of only ten times as high?

No doubt our housing conditions are not all they might be. But shouldn't someone tell Mr. Truman that in Moscow, even before the Nazi invasion, only one family in seventeen occupied more than a single room?

In America nearly three out of every four families has an automobile. Will we be inviting Communism until three out of every four families also has a yacht and an airplane?

As for political liberty, what sort of mentality is it that, because full political rights may in a few sections and cases be abridged here, prefers the sort of completely terrorized "elections" which were recently held in Czechoslovakia, and longs for the horrors of the Russian slave camps? Must everything be absolutely perfect here, must we produce a paradise on earth, to keep people from clamoring for the Communist hell?

Let us continue to improve economic conditions by all means. That, in fact, is what capitalism has been steadily doing for years, for generations. It has done it so well that its miraculous achievement is taken for granted, as if it were something that would occur automatically under any system. So Mr. Truman wants more houses, not through free enterprise, but through legislation and government subsidies. He wants higher wages, not through increased production, but through more coercion on employers. He wants to control inflation, not by reforming the government's own monetary and fiscal policies, but by the power to dictate prices—though the choking of production by price control abroad is one of the main reasons why capitalist America now supports planned and socialized Europe.

The way to combat Communism is to teach our people, and especially our political leaders, how infinitely superior capitalism has already shown itself to be. Certainly we are never going to win the struggle with Communism if we begin by accepting its basic principles and deserting our own, if we abandon our faith in personal liberty and free enterprise to embrace the Communist faith in government planning and government ownership, in bureaucratic omniscience and complete domination by the state. ❁



## Ordeal by Planning

June 28, 1948

It is fortunate that the publishers have so promptly made available an American edition of the most forthright and powerful attack on government economic planning that has appeared in England since the publication of F. A. Hayek's *The Road to Serfdom*. The new book is called *Ordeal by Planning*.

Its author is John Jewkes, professor of economics in the University of Manchester and a wartime member of the British bureaucracy. *Ordeal by Planning* should appeal to an even wider audience than *The Road to Serfdom*. While it lacks some of the philosophic penetration and depth of the Hayek book, it is much more explicit and concrete. Its style is lively, sparkling, and witty. It hits hard. It is difficult to see how any but the most fanatic government planners can fail to be shaken by it.

Mr. Jewkes assails central economic planning in all its aspects. He exposes the economic fallacies behind it; he ridicules its scientific pretensions; he points to its international, political, and moral dangers. He beautifully dissects planners as a species.

As one specific case, he cites the British coal and power crisis of February 1947—"the classic example of a planning crisis." In the preceding October the Minister of Fuel and Power himself had said with an irony that backfired: "Everybody knows that there is going to be a serious crisis in the coal industry—except the Minister of Fuel and Power." When the crisis arrived, "a government pledged to planning and economic stability was compelled to order, at a moment's notice, the closing down of about two-thirds of British industry."

"No country," Mr. Jewkes points out, "has ever suffered from a more sudden or catastrophic economic seizure. . . . The price system brings about gradual and continuous readjustment in a changing economic world; the central planning technique means that, from time to time, the economic system must be kicked downstairs."

"I believe," he continues, "that the recent melancholy decline of Great Britain is largely of our own making. . . . At the root of our troubles lies the fallacy that the best way of ordering economic affairs is to place the responsibility for all crucial decisions in the hands of the state." He lists the fateful errors made in foreign economic policy, the mistake of exchange control, the false alibis, the effort to put the blame on America. "Export planning," he concludes, "reduces exports."

But though he shows again and again how planning leads toward national impoverishment, his most powerful indictment of it rests on its destruction of freedom:

"When Sir Stafford Cripps declared in the House of Commons on Feb. 28, 1946, that no country in the world has yet succeeded in carrying through a planned economy without compulsion of labor, he might, with equal truth, have gone much further and admitted that no planned economy has yet operated without suppressing free speech, destroying representative government, robbing the consumer of free choice, and virtually abolishing private property. This is no accident. . . . It is due to the logical incompatibility of a planned economy and freedom for the individual."

This book has so many merits and presents its case with such cumulative force that I regret to have to mention one serious flaw. Mr. Jewkes surprisingly accepts the Keynesian theory that "mass unemployment is due to a deficiency of demand for goods and services," and that when it threatens, the state must intervene "either to spend more money itself or to put its citizens in the way of spending more."

This superficial doctrine is merely one of the countless disguises of the immemorial gospel of inflation. It is government planning in the field of money and credit: and its application in practice must inevitably involve the same sort of slapdash economic guesswork and shabby political abuse that Mr. Jewkes so brilliantly exposes in government planning in other fields. Rejection of the Keynesian fallacies is essential to the preservation of free enterprise. ☼

## Republican Platform Economics

July 5, 1948

The typical party platform is thrown together in a few hours by people who have little to do with carrying it out. It must compromise conflicting views within the party. It must lose nobody's vote. It must find verbal formulas that can mean all things to all men.

From this standpoint the 1948 Republican platform is a triumph of draftsmanship. It promises "elimination of waste" and of "unnecessary bureaus." It pledges "healthy" Federal finances, "stimulation of production," and a "sound" currency. Such planks can be opposed only by those who believe in waste, who want bureaus they admit to be unnecessary, who are eager to discourage production, and who favor unhealthy Federal finances and an unsound currency.

The platform endorses irreconcilable economic policies. It favors our "competitive system." But far from wishing to leave farm prices to this competitive system, it thinks they should be "supported on a just basis." The platform favors "progressive reduction of the cost



of government.” But it demands an increase of social security and veterans’ benefits “to a more realistic level.”

The platform promises to “assist other peace-loving nations to restore their economic independence”; but “only within the prudent limits of our own economic welfare.”

Everyone must decide for himself just how many billions this means. The platform promises to “support the system of reciprocal trade and encourage international commerce,” while, however, “at all times safeguarding our own industry and agriculture.” Everyone must decide for himself whether this means lower tariffs or higher tariffs. The platform thinks “housing can best be supplied and financed by private enterprise; but government can and should encourage the building of better homes at less cost.” Everyone must decide for himself whether the Republican Party is for or against large-scale government-subsidized housing.

We should not be too surprised to find in one of the major party platforms four years from now some such plank as this: “We favor a sound and prudent Communism, consistent with our free-enterprise system and traditional American liberties, and imposing only such reasonable and democratic controls as are necessary to make a wise and conservative Communist dictatorship fully effective.”

The platform favors “equal pay for equal work, regardless of sex.” Why not also regardless of race, color, religion, age, looks, or geographical location? Who is to decide whether or not the work of any two or more persons is in fact “equal”? A law to carry out this plank would in practice be merely one more abridgement of management’s right to manage.

One could discourse at length about the things that are *not* in the platform. It pledges “an attack upon the basic causes of inflation,” but does not clearly point out that the basic cause is the increase in the volume of money and bank credit. It says nothing whatever about the government’s cheap-money policy or about legal reserve ratios. It pledges “a sound currency,” but is silent about what constitutes soundness. It does not mention a return to a real gold standard. It is silent about the coercions and distortions of exchange control.

It says nothing about the European price fixing, planning, and Socialism that create the world shortages which the American taxpayer is called upon to make up. It does not even say clearly that it is against a return to price fixing here, or that it believes in free markets and free enterprise.

But there are worse things than silence or ambiguity. Platforms are seldom anything but an embarrassment anyway, particularly when they get specific. They

force the candidate into either an insincere lip service to every plank or an open repudiation.

It is hard to say which is worse—to make the right pledge and break it, or to make the wrong pledge and keep it—to violate outright, say, the 1932 Democratic platform pledges of “a saving of not less than 25 percent in the cost of Federal government” and “a Federal budget annually balanced,” or, as with the Labor Party in England today, to drive grimly ahead with more nationalization, in spite of demonstrated damage to the country, in the name of a party promise. ☸

## Dangers of Dollar Diplomacy

July 12, 1948

Perhaps the chief danger of the Marshall Plan is that it deflects public attention from the real political and economic problems that confront the world, while providing the illusion that something is being done to meet those problems. The crack within the Communist bloc is immensely encouraging, but the real question remains whether Washington will know how to make use of it. A continuation of our ambiguous postwar foreign policy, constantly wavering between firmness and appeasement, plainly cannot succeed. Whenever and wherever we appease him or give way to him, Stalin assumes—indeed the people behind the Iron Curtain and the people of Western Europe themselves assume—that we must be afraid of him. Every unrebuked insult or successful aggression can only encourage him to further insults and aggressions. His immediate aim has recently been to drive us out of Berlin; but his broader aim is to show the world who is master.

It follows from this that the true American warmongers are the appeasers, the Wallaces who think that they can buy peace by still more dangerous and humiliating concessions than those we have already made. The only possible way to assure peace, on the contrary, is by unyielding firmness before Stalin has been tempted to the ultimate reckless act.

What this means on the political side is clear. Against a great land power like Russia we could not possibly act on the European Continent alone. We could act only as an ally of Western Europe democracies resolved to defend their economic and political freedom. And we can secure such an alliance against Russian aggression only by willingness to give unequivocal military guarantees. We must be willing to guarantee the nations of the Western European union against any invasion of their territory or political integrity that

they themselves are prepared to resist. If any one of the European governments is too timid to accept our guarantee or to defend the integrity of its own country, then the sooner we find that out the better. It is folly to pour billions of American dollars into any country that is not clearly determined even to defend itself.

From the political side the central defect of the Marshall Plan is that it is not the implementation of a real foreign policy but an attempted substitute for a foreign policy. It originally appealed to many of its supporters because it looked like an effective measure for halting Communist expansion “short of war.” It was an attempt to buy European friendship with dollars. Such good effects as it had lay chiefly in its announcement. It was a way of saying to Western Europe: “We are with you.” But it was a needlessly expensive way; and in the long run it will prove an ineffective way.

For the Marshall Plan misconceives the economic disease from which Europe is suffering and misconceives the cure, which is not American dollars but internal reform. Except in Holland, and to some extent in Italy, there are few signs in Western Europe that economic reforms along the right lines are taking place. Promises of reform we have received in exchange for ERP are vague and rhetorical; and we appear satisfied with rhetoric rather than performance.

Virtually everything continues—the government planning, the allocations, rationing, price fixing, exchange control, overvalued currencies, and expanding socialism—that tends to make chronic the European shortages and trade deficits we are trying to cure. A French observer, Bertrand de Jouvenel, points out in the British magazine *Time and Tide* that “the largest drain on the French Treasury” and “the chief remaining source of inflation” is the deficit in the state-owned industries, which has been swelling day by day. It is this socialist deficit that American capitalism has now undertaken to finance. It is not surprising that European recovery does not take place.

Military aid, in return for a dependable united European front, would be a rational American foreign policy. But we are turning over billions of dollars to Europe in return for something so indefinite that no one seems quite to know what it is. ❀

## Collectivism on Relief

July 19, 1948

The Marshall Plan is now in operation; and one of the chief misgivings of its critics is already being realized. This is that America would pour money into Europe

without getting in return reforms that would really bring European recovery.

Nothing in the agreements concluded between the ECA and participating countries promises any real change from the ruinous postwar economic policies that these countries have been following. The British Government agrees, for example (and there are only minor differences in the French and other agreements), to “use its best endeavors” to make “efficient and practical use of all the resources available to it”; to think up “practicable projects for increased production of coal, steel, transportation facilities and food; to stabilize its currency, establish or maintain a valid rate of exchange, balance its governmental budget, create or maintain internal financial stability, and generally restore or maintain confidence in its monetary system; and to cooperate with other participating countries in facilitating and stimulating an increasing interchange of goods and services.”

Most of these promises are so vague as to be practically meaningless. They refer to ends, not means. Of course every government wants to use its resources efficiently: Of course it wants economic recovery, increased production, and a stable currency. It does not need to be bribed to want any of these things. The real question is: Has it been following or will it follow the policies likely to bring them?

In the opinion of the British authorities themselves, nothing in the agreement they have signed will require them to change their present collectivist course. As the London financial correspondent of *The New York Times* cabled: “Britain is, in fact, already doing its utmost to achieve these objectives. . . . On the question of early revision of the exchange value of the pound sterling, there is nothing in the agreement to suggest that this is at all likely or is at all necessary.”

So that’s that. Yet the simple truth is that European exchange control and overvalued currencies have not only brought about a chronic European trade deficit, which the American taxpayer is subsidizing, but have jammed up international trade and made such trade all but impossible even within Europe.

A recent Associated Press dispatch from London opened with the statement: “Trade in Western Europe is on the decline because most of the countries are too poor to buy from each other.” This is nonsense. The people *within* each of these countries are obviously not too poor to buy from each other. Countries that have things to sell to each other can obviously exchange them with each other. But when they set up a nightmarish system of bilateral quotas and import licenses for every transaction; when they insist on a pegged value for their own

currencies far above what any free market will pay (or, to put it another way, when they forbid their own citizens to pay for American dollars the value that a free market would place on such dollars); when, in short, they make their currencies in fact inconvertible and *prevent* their citizens from buying other countries' goods, then they must inevitably expect exactly the kind of breakdown of international trade that they have got.

The ECA agreements, with their vague rhetorical promises, will do nothing to halt the socialism, inflation, price control, exchange control, and government planning that are everywhere choking production and trade. Even the requirement for balanced budgets is rendered meaningless by exempting "deficits over a short period"—the length of which is nowhere specified. As for the interpretation of these pledges, is Britain helping to "maintain confidence" in its own money when it prohibits anyone from bringing more than £5 of it back into the country?

The Marshall Plan was put forward to aid participating nations "through their own individual and concerted efforts." It is in fact a costly relief program that is not getting in return the only reforms that would make a real and lasting recovery possible. ❁

## Democratic Platform Economics

July 26, 1948

The ideal that emerges from the Democratic platform is the complete paternalistic state. Less and less are the people to do anything for themselves. More and more are the bureaucrats to do everything for them—insure their health, federalize their education, build their homes, boost their wages, raise the prices at which they sell and lower the prices at which they buy. Everybody is expected to owe everything to the officeholders in Washington. Everybody is expected to forget that the officeholders can give nothing to B and C and D unless they have first taken it from A. A is the taxpayer, the forgotten man. The effect of confiscatory taxation on his incentives and on the national production is ignored. Spend and spend, tax and tax, and—elect and elect?

The sheer effrontery of some of the economic planks in the Democratic platform makes them read like intentional humor. "The Republican 80th Congress is directly responsible for the existing and ever-increasing cost of living." Why? Because it refused to give Mr. Truman power to dictate prices. Mr. Truman thinks that the cause of inflation is the absence of price control. Nowhere in the Democratic platform are the real causes of inflation so much as whispered. Nothing is

said about the threefold increase since 1939, brought about by Democratic fiscal and monetary policies, in the volume of money and credit. No connection is pointed out between all the foodstuffs being shipped abroad under the Marshall Plan and the consequent rise of food prices here.

The platform, in fact, demands still higher Federal spending on everything—social security, education, housing, veterans, public works, TVA's, school lunches. Though the American taxpayers stagger under the greatest absolute peacetime burden of expenditures that the taxpayers of this or any nation have ever been asked to bear, they are calmly informed that their expenditures are still "inadequate."

Affecting to deplore high prices on one hand, the platform boasts of them on the other. It is stuffed with figures on the increase of wage income, farm income, business and professional income. It never once seems to have occurred to those who inserted these figures that they are simply high prices looked at from the other side. If the Republican Congress is responsible for the high prices that consumers pay, then it should also get credit for the high prices that producers receive. They are precisely the same prices. But the Democrats blame the first on the Republicans and grab credit for the second themselves.

Indeed, they want to boost prices and costs still higher. They insist on jacking up minimum wages from 40 to 75 cents an hour—an increase of 87½ percent. This would, of course, push up wages all along the line, for skilled workers would insist on the maintenance of existing differentials. Pushing up costs further would push up prices further.

The platform insists on still more direct ways of increasing prices. Though in one section it complains that food is becoming too expensive for the average wage earner "and the prospects are more frightening each day," it demands at another point "a permanent system of flexible price supports for agricultural products"—to make the prospect still more frightening. If a permanent system of price supports for agricultural commodities, why not a permanent system of price supports for all commodities? Why the discrimination? Could a shabby and unprincipled scramble for votes have anything to do with the matter? Yet while demanding that the prices of unionists and farmers be pushed up by law, and that the prices of nearly everybody else be pushed down by law, the platform blandly declares itself in favor of "free enterprise" and opposed to any "arbitrary and discriminatory restrictions."

On labor relations the platform is even more inconsistent, if that is possible. It demands "the repeal of the



Taft-Hartley Act.” This is a direct repudiation of the party’s own Congressional record. Only 81 Democrats in Congress voted against the Taft-Hartley law, while 120 voted for its enactment. In fact, 126 Democrats in Congress voted to override the Truman veto, compared with only 93 who voted to sustain it. What a plank for that record! ❁

## The Phony War against Inflation

August 2, 1948

It is one of the supreme ironies of the political situation that not only President Truman but many editorial writers, and even a number of Republicans themselves believe that he has put responsibility for inflation squarely in the Republican lap unless they give him price-fixing powers. Nothing could more clearly reveal the appalling confusion of thought in the country concerning the real nature, causes, and cure of inflation.

The truth is that Mr. Truman and his government have been following a reckless inflationary policy. The Democratic platform insists on an even more reckless inflationary policy. The Republicans do share responsibility for inflation, but chiefly because they have done so little to stop him. The special session on which he has insisted gives them the opportunity to make up for past negligence.

In this column of April 26 I suggested the form that a Congressional anti-inflation program might take. I pointed out then that “inaction on this subject would be a mistake not only from the national standpoint, but even from the standpoint of Republican prospects in November. Unless the Republican majority in Congress itself frames and passes a positive anti-inflation program,” I continued, “its criticisms of President Truman’s policies will seem very unconvincing by election day if inflation resumes its progress in the next six months.”

The four-point program that I suggested is, in summary: (1) Congress should authorize or direct the Federal Reserve Board to restore the former legal requirements of 35 and 40 percent reserves in the Federal Reserve Banks instead of the present 25 percent reserve requirement. (2) It might authorize the Federal Reserve Board to increase the reserve ratios of member banks, but only after the board had first restored the Reserve Bank ratios. (3) It should terminate inflationary monetary measures still on the books. (4) It should make a general declaration of policy directing the Federal Reserve Board to stop further inflationary expansion of money and bank credit. “Only by

such a comprehensive measure (combined with sounder expenditure and tax policies),” I concluded in the April 26 column, “can Congress prevent the present inflation from going farther. Only by such a measure can it take the offensive in the battle against inflation and center public attention on the fact that it is, above all, government fiscal and credit policy that creates inflation. Otherwise President Truman will continue inflationary monetary policies while declaring, as in his speech to the American Society of Newspaper Editors, that the only cure for inflation is to give him power to fix prices.”

As Mr. Truman has followed precisely this course and as inflation has resumed its progress, something must be said about the new demands for rationing and price-fixing, particularly with regard to meat. Nothing could be more illogical or hypocritical than these demands in view of all the other government policies that are being followed. The price of meat is inescapably linked to the price of feedstuffs. When we ship feedstuffs abroad in great quantities, when we put high government support prices under them, we inevitably increase the price of meat. Rationing and price fixing are not merely irrelevant but fraudulent cures. They intensify the evil they seek to remedy. If we legally push down the price of meat, while bolstering up the price of feedstuffs, we remove the incentives for feeding and growing meat and so still further reduce the meat supply.

In following inflationary policies and then demanding price-fixing powers to stop inflation, Mr. Truman is like a man who throws a child into the water and then tears off his coat and proclaims himself to be the ideal and only possible rescuer. The one sensible reply that Congress can make is to order the culprit to arrest himself. If Congress passes a program that goes to the heart of the monetary cause, it will put Mr. Truman on the spot. If he vetoes the bill the phony nature of his demand for an end to inflation would be exposed and if he accepts it inflation could really be stopped. ❁

## Will Inflation Stop Inflation?

August 9, 1948

More than any other single man, President Truman is responsible for the inflation that has developed here since the end of the war. Yet no one seems more blissfully unaware of this fact than Mr. Truman himself. Let us look at his new eight-point “anti-inflation” program:

1—An excess-profits tax “to provide a Treasury surplus” and “a brake on inflation.” This cannot be taken



seriously as a revenue-raising measure. Corporation taxes are already dangerously excessive. They are preventing the accumulation and investment of new capital essential for increasing national output and real wages. An excess-profits tax would reduce and unbalance production and increase inflation.

2—Consumer credit controls. Mr. Truman wants the government itself to extend more inflationary credit to build and buy houses, but wants to curb private credit to buy refrigerators to put in the houses.

3—More authority to the Federal Reserve Board to “regulate inflationary bank credit.” The board keeps demanding new powers while refusing to use those it already has. It wants power to raise legal reserve ratios of member banks. It should first be granted the power—for which it has not asked—to restore the former legal reserve ratios of the Federal Reserve Banks themselves. Reserve-bank credit is far more inflationary than member-bank credit.

4—Power to “regulate speculation on the commodity exchanges.” Speculation smoothes out price fluctuations and continuously adjusts demand to supply. Speculators do not do this perfectly, because no one can perfectly foresee the future; but they do it incomparably better than could politically motivated politicians.

5—“Allocation and inventory control of scarce commodities.” Free markets can do this far better than any government. Government allocation breeds political favoritism and corruption.

6—“Strengthening” of rent controls. Rent controls have intensified the housing shortage by encouraging existing tenants to use space wastefully, and by discouraging repairs, improvements, and new construction.

7—“Stand-by” powers to ration products “in short supply.” To the extent that rationing really does cut down demand and lower prices, it also lowers production of the rationed product. It intensifies the very shortage it is designed to counter.

8—Price control for scarce commodities. This is the very thing that makes them scarcer, by lowering the relative profit margin in producing them. Mr. Truman would approve “non-inflationary wage increases”—a wonderful phrase. Mr. Truman is sure in advance that many wage increases can be “absorbed within the price ceilings.” This means that he would boost wages further at the expense of profit margins and give officeholders life-and-death powers to determine the profits of every industry and firm. The totalitarian nature of price fixing should be clear.

Mr. Truman does think that the government should have power “to limit wage adjustments which would force a break in the price ceiling.” But he would

even break price ceilings “to correct [wage] inequities.” This lip service to wage control should deceive no one who remembers our experience before Congress took price-fixing powers away from Mr. Truman.

After this eight-point “anti-inflation” program, Mr. Truman recommends every inflationary measure in the book. He wants an inflationary minimum-wage increase, which would raise production costs throughout the economy. He wants more Federal expenditures for housing projects, education, electricity, and a further boost in Federal salaries. Not once does he stop to announce or even to express any interest in how much these new inflationary expenditures would raise our already fantastically inflated Federal budget. He never mentions the budget deficit predicted even before these demands by his own Secretary of the Treasury. It is deficits that make inflation.

The cure for the evils of inflation, he thinks, is more inflation. ❁

## Dollar Shortage Forever

August 16, 1948

This title over a recent article in the London *Economist* raised for a fleeting instant the hope that that distinguished journal had at last recognized the elementary truth that the [so-called] world “dollar shortage” will continue just as long as governments refuse to permit their citizens to pay the world market price for dollars. But, alas, the article merely embraced every hoary mercantilist fallacy from Colbert to Keynes.

*The Economist* believes, for example, that the spectacular successes of the free market in the nineteenth century occurred “only because there was in the world a natural equilibrium.” This is nonsense. Equilibrium between supply and demand, between exports and imports, is brought about not by nature but by prices—by free prices in free markets.

“The continental United States,” continues *The Economist*, “unlike the tiny British Isles, can produce all the food and most of the raw materials it needs. . . . America does not, as Britain did even in the days of its ascendancy, inevitably buy as much abroad as it sells there. . . . It seems overwhelmingly probable that the dollar shortage will last for a generation to come.”

One hardly knows where to take hold of anything so wrong. We are not economically self-contained. We depend on foreign sources for our sugar, coffee, tea, cocoa, wool, natural rubber, and other items too numerous to mention. And in any case we must inevitably buy as much abroad as we sell there, for the simple

reason that the only alternative is to give our goods away. To “lend” foreign countries the dollars to “buy” our goods, and never to get repaid, is just a disguised way of giving. This is not lack of equilibrium, but lack of sense.

The “dollar shortage” of which Europe and the rest of the world today complain is not the result of some singular self-containment on the part of the United States. It is the result solely of overvalued currencies under exchange control. When a government overvalues its paper money and then calls out the police to prevent its own citizens from buying or selling their own or foreign money at the rates at which they want to buy and sell, it systematically strangles its foreign trade. Exchange control, overvalued currencies—and the whole system of import and export licenses, bilateralism, quotas, allocations, price controls, and government planning that goes with it—have finally jammed up practically everything but government subsidized trade, not only between Europe and the United States but even inside Europe itself.

And now—under government sponsorship, of course—we are about to teach British businessmen their business. On the theory that they wouldn’t do it for themselves, our government is going to prod them into becoming more efficient and giving us tougher competition for world markets. One defect of this plan is that it is entirely irrelevant to the problem we are trying to solve. That problem is the trade deficit. Even if we succeeded in increasing British production by our patronage, it would not cure the British trade deficit. On the contrary, with an overvalued pound, increasing British production would increase the British trade deficit, Britain would have to import more raw materials for its industries; and British consumers, with more income in pounds, would want to buy more British products as well as more food, tobacco, refrigerators, and automobiles from us, or whatever else their bureaucrats would let them have.

A correction of the British (or French or Dutch or Norwegian) trade balance could be forced practically overnight, however, by simply allowing exchange rates to find their own market levels. This would discourage imports and encourage exports; it would make all currencies automatically convertible in any amount desired; and the “dollar shortage,” in the sense in which the phrase is now used, would disappear. Any nation will have a trade deficit as long as it insists on overvaluing its currency. The world dollar shortage will last as long as world exchange control. And the American taxpayer will continue to foot the bill. ❁

## Hypocrisy about Inflation

August 23, 1948

When we keep in mind the demagogic bombardment to which it was subjected by the President, the record of the special session of Congress was far better than might have been expected. Its virtues consisted chiefly in what it did not do. It ignored most of what would have been the disastrous program proposed by Mr. Truman.

It did pass a modified housing bill, not inflationary enough to satisfy Mr. Truman, of course, but nonetheless inflationary. Mr. Truman himself pointed out in his recent economic report that the present “volume of residential construction is already straining the capacities of the construction industry” and “competing with other primary national needs.” The further doses of government credit made available in the new housing law, therefore, are not likely to increase the volume of the nation’s new housing, but merely the cost of that housing.

The controls that Congress reimposed on consumer installment credit touch only the fringes of inflation. Many consumers will simply draw down their savings accounts or sell Series E bonds to make their purchases. To the extent that installment credit controls really are effective, they will simply shift buying away from durable products like automobiles, refrigerators, and furniture into more perishable goods. For installment credit does nothing in the long run to increase the total volume of consumer buying. The \$50 a month that a family puts aside to meet installment payments cannot be spent on books, sundaes, cigarettes, or movies. Finally, one must point out once more the glaring inconsistency of liberalizing government mortgage credit for homes while tightening private credit for furnishings to put in the homes.

Nor did Congress accomplish anything important when it gave the Federal Reserve Board power to increase reserve requirements of member banks by 4 percentage points against demand deposits and 1½ percentage points against time deposits. For under present conditions the member banks can simply rediscount or sell their government securities to the Federal Reserve Banks, which stand ready to receive them at guaranteed minimum prices.

The one really important anti-inflation step that the House took was thrown out by the Senate. This was the provision restoring reserve ratios of the Federal Reserve Banks themselves to the legal requirements, which existed up to 1945, of 35 percent against deposits

and 40 percent against notes, compared with the present “emergency” requirement of only 25 percent.

The mutually contradictory reasons which were put forward for rejecting this revealed the appalling confusion and hypocrisy that still exist in Washington regarding inflation. Some opponents dismissed it as “meaningless,” on the ground that Federal Reserve Bank reserves are already above 35 and 40 percent. These critics, in other words, believe that we shouldn’t lock the stable until after the horse has been stolen. It is precisely because reserve-bank ratios are still above 35 and 40 percent that we could safely restore the legal requirements now without monetary disturbance. The purpose would not be to roll back present inflation but to limit future inflation. The Secretary of the Treasury and the representatives of the Federal Reserve System who appeared before Congress realized this. They opposed the provision precisely on the ground that it would ultimately prevent the Federal Reserve Banks from continuing to inflate by supporting and monetizing government securities.

Congress should have forced the Federal Reserve authorities to put their own house in order before giving them more powers over member banks and installment credit. It should not only have restored the original reserve-bank reserve ratios, but required the reserve board to add at least one additional percentage point to the Federal Reserve Bank reserve ratios for every additional point that the board thought necessary to add to member-bank reserve ratios. But Congress merely gave the authorities more power to prevent others from inflating, while leaving them free to continue to inflate recklessly themselves. ❁

## A Bear by the Tail

August 30, 1948

On Aug. 9 the Treasury announced that interest rates on its one-year certificates would be raised to  $1\frac{1}{4}$  percent from the then-existing rate of  $1\frac{1}{8}$ . Three days later Federal Reserve Banks in nine of the twelve districts raised their rediscount rate from  $1\frac{1}{4}$  to  $1\frac{1}{2}$  percent. These were belated moves.

Secretary Snyder described the government’s action as a “further anti-inflationary move.” This was overstating the case. No inflation on record has ever been stopped with a rediscount rate of  $1\frac{1}{2}$  percent or short-term rates to private borrowers running as low as 2 percent. It is only because we have become accustomed in

late years to infinitesimal short-term interest rates of a fraction of 1 percent that rates of  $1\frac{1}{2}$  and 2 percent can be solemnly described as “anti-inflationary.”

The importance of the increase is purely symbolic and psychological. As Thomas B. McCabe, the new chairman of the Federal Reserve Board, put it: “Each increase in the rediscount rate repeats the warning that credit is in need of continued restraint.”

But what the Administration is at last doing in the realm of tightening interest rates is inconsistent with what it has been doing in the government bond market. In the year ending Aug. 18 the Federal Reserve Banks bought \$6,690,000,000 additional government bonds. The effect of such purchases was described by Chairman McCabe in his recent testimony before the Senate Banking and Currency Committee:

“The result of these purchases of government securities by the Federal Reserve Banks is to supply additional reserve funds to banks. . . . These new reserves in turn provide the basis for an increase in bank credit that may be many times the amount of new reserves obtained. . . . The effect has been to increase significantly, and it may be dangerously, the money supply. . . . If the policy of maintaining the  $2\frac{1}{2}$ -percent yield level on long-term Treasury bonds is continued . . . additional reserve funds would be made available to banks which, unless otherwise offset, could sustain a further very large inflationary expansion of bank credit. . . . Further credit expansion will add to the pressure for rising prices. Continued credit expansion will store up trouble for the future and make the inevitable adjustment more dangerous for the stability of the economy.”

When the support of government securities at present levels is admitted to be so dangerously inflationary, why is it continued? Why did the Federal Reserve authorities even oppose a restoration of the former Federal Reserve Bank reserve ratios of 35 and 40 percent, which would have put a future curb on such support? Chairman McCabe explains: “The system has made a public commitment to support the  $2\frac{1}{2}$ -percent yield level on long-term government bonds for the foreseeable future.” Why did it make this commitment? Well, it is always politically embarrassing to have government bonds selling below par. More important, the banking system is loaded up with government bonds. Many fear that its very solvency would be threatened if these bonds were allowed to fall below a moderate discount in the market. There are various ways in which this problem might be dealt with. I hope to discuss them here in a later article. But I can reveal in advance



that none of them is free from awkward aspects. This should not come as a surprise. If a reckless inflation could be stopped at any time in an easy and pleasant way, the case would not be so strong against embarking upon it in the first place.

One thing is certain. We can only make the termination more difficult and dangerous the longer we attempt to put it off. The Administration has a bear by the tail. It must either recklessly continue to support government bonds at an interest yield of 2½ percent, and make them the basis for bank reserves and further credit inflation, or it must halt this process by some method that is bound to have its unpleasant features. Competent and responsible fiscal and monetary managers would have seen this dilemma coming. They would not have embarked upon easy short-run policies with an attitude of "*après nous le déluge*." ❁

## Repressed Inflation

September 6, 1948

In *Kyklos*, a quarterly published in Bern, Switzerland, the European economist Wilhelm Röpke in 1947 diagnosed the central economic disease of Europe as "repressed inflation." The truth of this diagnosis has become increasingly clear. The disease it describes prevails today not only in Europe but in Asia, Africa, and Latin America. It has been imposed on postwar Germany and Japan with the energetic cooperation of our American administrators. It is the disease which President Truman would unwittingly impose on the United States itself. We should do well, therefore, to study the nature, origins, symptoms, prognosis, and cure of this malady.

Repressed inflation begins, like open inflation, by printing too much money in relation to goods. This may be caused by a war, by an occupation, by a cheap-money or a so-called "full-employment" policy, or by some combination of these. Under an open inflation the effect of too much money would be a general increase of incomes, prices, costs, and foreign exchanges. The government wishes to avoid these soaring internal prices and foreign exchanges, but it refuses to abandon the inflationary fiscal and monetary policies that cause them.

Therefore it *forbids* the excess of monetary demand to result in increased prices, costs, and exchange rates. For free markets it tries to substitute a system of ceiling prices combined with rationing, allocations, import

prohibitions, and exchange control—in short, a network of coercions, all under the euphemistic name of "planning."

Every economic transaction becomes politicized. Even money no longer has any definite value except when combined with ration coupons or some discriminatory license. An open inflation, it is true, causes crying injustices and leads to unbalanced production. But a repressed inflation is even worse. It adds stagnation to unbalanced production and unjust distribution.

Under repressed inflation the budget usually remains unbalanced. Low interest rates are arbitrarily maintained. These encourage excessive borrowing and further monetization of the public debt. To counter its own inflation the government is constantly compelled to increase its counterpressure or repression.

The whole system of compulsory values becomes constantly more fictitious. Unbalanced production, chaos, and stagnation assume more alarming proportions. The population reacts by mounting discontent, distrust, disobedience, and bewilderment. The government is finally left with no choice but to admit its defeat or to resort to complete totalitarianism. The bureaucrats argue that they must keep their coercive controls until production has increased enough to relieve the pressure of inflation and to enable them to dismantle the control machinery. They think they can close the gap between money and goods by increased production. But they fail to recognize that it is exactly their repressive controls that are stifling production. They refuse either to mop up the previous surplus of money that has caused the inflation or to balance their budget and discontinue their cheap-money policies. So the gap between goods and money tends to become greater rather than less.

Most of the advocates of repressed inflation still talk as if their country were a besieged fortress where a given amount of goods had to be distributed equally. They cling to the melancholy ideal of a "poorhouse socialism." They overlook the fact that their real problem is to increase production. And they adopt precisely the measures that prevent this. Their policies finally force the emergence of black markets.

Economically (though not politically) the cure for repressed inflation is simple. It is, on one side, to mop up surplus money, to balance the budget, and to halt the further expansion of money and bank credit. On the other side, it is to throw out price and exchange controls and to let prices and production be determined by free markets and free competition. This is the only way to get maximum balanced production of goods consumers want. ❁



## Does Stalin Want War?

September 13, 1948

Does Stalin want war? This is not only the most fateful political question that confronts the world today, but the most fateful economic question. Economically, it overshadows inflation, for the extent of inflationary pressure will itself depend in large part on the issue of war or peace. War dictates the level of taxation and the whole structure of production. The recent diplomatic tension has been a major influence on our commodity and security markets, on business sentiment and business plans.

If it takes two to make a war, it also takes two to keep the peace. And whatever Stalin wants today, he does not primarily want peace. No one who sincerely yearns for peace would turn loose every organ of propaganda against us; would order a daily barrage of vilification; would daily trump up new accusations and new lies against us; would systematically sow suspicion and hatred against the Western democracies; would use his consulates and embassies abroad as propaganda centers and espionage nests against the countries that harbor them; would daily raise new issues, think up new insults, create new crises; would cut off rail access to Berlin, “buzz” our supplying planes, arrest our representatives—do everything, in short, calculated to provoke an incident that might touch off a war.

In 1946, at Fulton, Mo., Winston Churchill said he did not believe that the Soviet leaders wanted war: what they wanted were the fruits of war. But as the London weekly *Time* and *Tide* has put it, the Soviet leaders have since shown that “they are determined to have what they want by almost any means, and perhaps by *any* means.”

In the *New Leader* of July 24, David J. Dallin, the author of “Soviet Russia’s Foreign Policy,” declared that “the Kremlin no longer questions the conclusion that war is bound to come—if not tomorrow, then the day after.” Dallin interprets its present policy as an effort to create incidents or situations that will provoke us into shooting first, “so as to enable Moscow to place the guilt for the first shot squarely on Pennsylvania Avenue and Downing Street.”

But whether or not Stalin really wants a shooting war, he obviously means to continue his cold war. He will use every economic weapon. In the countries that he takes over, he will continue to confiscate savings, to destroy private initiative, to nationalize, collectivize, and regiment. And he will continue to thwart or sabotage every measure designed to restore or rebuild the world economy.

Fortunately, whatever Stalin’s intentions, our own proper counteraction is clear. It must be a policy of absolute firmness. Whether Stalin is bluffing or whether he really wants war, we have nothing to gain and everything to lose by continuing the course of feeble concession and appeasement we have followed for the last three years. Whenever we capitulate, we not only weaken our position, but we confirm Stalin’s opinion that we are already weak and afraid of him. We embolden him to new aggressions.

The chief reason we have been losing the cold war with Russia is that we have remained purely on the defensive. Paradoxical as it may seem to some, our one hope now of preventing a shooting war is to seize the offensive in the cold war that Stalin has been waging against us.

We must offer unequivocal military guarantees to the Western European union. We must support China in its fight against the Communists, economic chaos, and Soviet aggression. We must keep probing for Stalin’s weak spots. And we must embark upon a positive and relentless propaganda campaign of our own, not merely on political disputes but on the unworkability and slavery of Communism and on the freedom and productivity under capitalism.

The most serious obstacle to this program is that our present officeholders do not know how to present the case for capitalism. They have, in fact, no real understanding of it and no real faith in it. This is the real weakness of the West. ❁

## The Ethics of Capitalism

September 20, 1948

The “Christian Church,” concluded the original draft of a report to the World Council of Churches, “should reject the ideologies of both Communism and capitalism, and should seek to draw men away from the false assumption that these are the only alternatives.”

The implication of this sentence is that Communism and capitalism are about on a par as major evils. But the means of production must either be owned by private individuals, which is capitalism, or by the state, which is Communism or socialism. Dr. John C. Bennett, who drafted this plague-on-both-your-houses, has admitted that British “democratic socialism” comes closest to what he had in mind as the undisclosed Third Way, the “new creative solution.”

Now the belief that we can have socialism and still retain human liberty and avert state despotism has proved to be the great delusion of the present age.

For when the state controls everyone's means of livelihood, it inevitably uses this power to suppress freedom of speech. It is naive to suppose that the individual will in fact be free to criticize the rulers who can decide what job he will take or whether he can have a job at all.

The Stalins and Titos have in fact used such power not merely to suppress all criticism but to compel the most abject and nauseating flattery. But Communism is merely the name for what happens when socialism becomes complete, or nearly so. Liberty shrinks in direct proportion as socialism advances.

As a result of protests, the final version of the report to the World Council of Churches put the modifier "laissez-faire" in front of "capitalism"—but apparently only in the sentence I have quoted. It is difficult to measure the precise effect of this change. Much depends upon the interpretation of "laissez-faire." It has long been used as little more than a term of abuse, synonymous with anarchy. Only the unregenerate and depraved are thought still to believe in it. When used by the classical economists, however, the phrase presupposed a framework of law and order, under which the state illegalized force, theft, fraud and the breaking of contractual promises, but otherwise permitted free markets and refrained from detailed economic restrictionism.

To reject "laissez-faire capitalism," therefore, is by implication to reject free markets and presumably to endorse some sort of state "planning." This euphemism for collectivist coercions and compulsions ought by now to have been sufficiently discredited by what is happening in England, France, and a score of other countries, where the collapse of state planning has led to increasing dependence on capitalist America, to chronic shortages, black markets, and moral cynicism.

A churchman remains within his spiritual province as long as he criticizes economic systems purely on ethical grounds. But he cannot competently do this unless he really understands the economic system he is presuming to judge. And this understanding requires more arduous study than the authors of the World Council of Churches report appear to have devoted to it.

What, for example, is "justice" in an economic system? Is it the equalization of rewards regardless of the contribution that anyone makes or fails to make to the social product? To many of us a system under which the talented and skilled and industrious received no more than the incompetent and shiftless and lazy, and which equalized rewards irrespective of effort, would be not only unjust but, what is worse, unproductive. Most of us, if we thought that were the only alternative, would prefer an enormously productive if not ideally just system

to one which provided a perfectly "just" distribution of scarcity and poverty.

Fortunately, a free capitalism not only provides both more liberty and welfare than any other system, but more economic justice. Under it most of us, in spite of exceptions, get approximately the economic value that we ourselves contribute to the total social product. That is how the system provides incentives. Keep improving it, certainly; but don't "reject" it. ❁

## The Fetish of Bond Parity

September 27, 1948

The support of the government bond market by the Federal Reserve System, in order to hold the price at par, is today the principal inflationary factor in our economy. Chairman McCabe of the Federal Reserve Board virtually conceded this in his recent testimony before the Senate Banking and Currency Committee: "If the policy of maintaining the 2½ percent yield level on long-term Treasury bonds is continued . . . additional reserve funds would be made available to banks which . . . could sustain a further very large inflationary expansion of bank credit."

Yet the policy has not only been continued since he spoke, but continued on an increased scale. The Treasury and the Federal Reserve authorities, in short, prefer to risk a reckless inflation to doing anything to halt or curb the present policy of pegging government bonds at par. Perpetual parity for the outstanding government long-term bonds has become sacrosanct and untouchable. It is a fetish to which all other economic aims are now subordinated.

Yet the reasons for this policy, when ventilated, turn out to be far from convincing. The most important of them is that, if the government bonds were left to a free market, they would fall to a discount that would threaten the solvency of our banking system. I shall postpone to a subsequent column discussion of the possible ways of preventing such a consequence. The fallacy in the argument that the government must hold down interest rates "to reduce the burden on the taxpayer" I have already pointed out in a previous column "Cheap Money Means Inflation" (*Newsweek*, Dec. 8, 1947).

But perhaps the greatest irony of the inflationary bond buying policy is that even its supposed direct beneficiary, the government bondholder himself, is not protected by it. On the contrary, he is a victim of it.

There is a widespread notion that the government "broke faith" with its bond buyers of the first world war because Liberty bonds were allowed to fall at one time

to as low as 82 in the open market. Never again, said the second world war authorities, would so awful a thing happen. The new bonds would always be kept at par or better. So far they have been. And as a result the government bondholder of the second world war has suffered a much more real loss than the bond buyer of the first. When the Fourth Liberties fell to 82 in May of 1920, their owners were certainly not happy. For the cost of living had risen 26 percent from the day the bonds were issued in October 1918. When the bonds had fallen to 82, in other words, the purchasing power of the investor's original dollars had fallen to 79 cents. For every dollar he had invested in the bonds the buyer then had a net purchasing power of only 65 cents. But this situation lasted for only a few months. It adversely affected merely the few who were forced to dispose of their bonds in that short period. Those who held on to them until they were redeemed in 1933 were not only paid off 100 cents on the dollar, but had the added advantage of a decline in living costs. For every dollar he had invested the buyer received in return (in addition to the interest in the meantime) a purchasing power of \$1.28.

True, the present war bonds have been maintained on the market at par—in terms of dollars. But in order to keep the bonds at par the debt has been monetized, inflation has been increased, and the purchasing power of the dollar itself has been lowered. Though the war bonds issued in November 1942, for example, still sell around par, their purchasing power at par, in terms of living costs, is now only 69 percent of what it was when the bonds were bought.

The holder of these bonds, in other words, has not only suffered a decline of some 30 percent in the purchasing power of his bonds if he has to sell them now, but he is destined to suffer an even greater decline if an even higher price level prevails at the time of redemption. And an even higher price level surely will prevail if the present bond support policy is continued. So far as the interests of the bondholders are concerned, in short, the mere dollar "parity" maintained by present inflationary support policy is a delusion. ☸

## Bond Parity without Inflation

October 4, 1948

The present pegging of the government bond market by the Federal Reserve Banks, in order to hold the price up to par and keep the yield down to 2½ percent, is today the principal inflationary danger in our economy. The most important argument of those who

insist on continuing this inflationary support policy is that if government bonds were left to a free market they would fall to a discount that would threaten the solvency of our banking system. Insofar as this fear has substance, there are several ways in which such a consequence could be prevented.

A substantial budget surplus and a continuous retirement of the public debt (at an average rate, certainly, of not less than \$2,500,000,000 annually over the next decade) is at least an essential part of any solution of the government-bond problem. But it is far from the whole solution.

The economist Benjamin M. Anderson has proposed that the outstanding debt should be funded by offering private investors new long-term government bonds at rates of interest "that will really attract them." To protect the banks in this change of policy, he suggests that banks holding long-term government bonds "be allowed to exchange them for new issues at the higher rates of interest, at a discount of, say, 2 percent as compared with cash subscribers, leaving them with some loss but not with losses that would ruin their depositors." One drawback to this proposal is that the Treasury could not know in advance precisely what long-term rate of interest would be most economical and yet high enough to prevent the specter of a substantial discount on bank-held government bonds from arising all over again at a later time.

This difficulty is not insurmountable. One way of meeting it would be for the Treasury to offer to exchange outstanding long-term bonds for coupon bonds with a *fluctuating* rate of interest. Such bonds would provide, for example, that at the beginning of each six-month interest period the coupon rate would be changed to correspond (to, say, the nearest eighth of 1 percent) to the actual yield on the bonds at their market price at the end of the preceding six-month interest period. By this automatic device the new bonds could always be held very close to par. Their market value, in fact, ought not to fluctuate in a much wider range than those of six-month certificates.

On such a bond, it is true, the Treasury could not know in advance precisely what average interest rate it would have to pay over the following fiscal year. This uncertainty, however, would be no greater than that already attached to the Treasury's short-term financing. And the risk that the government would be obliged to pay higher interest rates is a very minor evil compared with the further inflation that a continued effort to avoid paying higher interest would inevitably produce.

Such variable-coupon bonds, of course, would not be offered to raise new funds but only as a conversion



privilege to holders of outstanding long-term bonds—only in exchange, say, for outstanding bonds with a maturity more than five years off. New orthodox fixed-interest long-term bonds could later be put out for non-bank investors at favorable opportunities, and the proceeds used to retire outstanding variable-coupon bonds. Neither the Federal Reserve Banks nor the member banks should be permitted to buy any more of the variable-coupon bonds or, in fact, any government security with a maturity longer than five years. And the Federal Reserve bond-pegging policy should, of course, be halted.

A detailed proposal for a fluctuating-coupon bond, I find, was put forward in early 1942 by a business analyst, W.W. Townsend. The object of his proposal at that time, however, was to enable the country's banking system to absorb with safety the maximum volume of bonds to finance the war. The purpose of such a plan at present would be to make it clearly safe for the country's banking system to *stop* buying outstanding bonds and to *sell* long-term government bonds as rapidly as nonbank investors could take them up. ❁

## Suppressing Free Markets

October 11, 1948

At a few points the annual report of the International Monetary Fund touches reality. It declares that “the European countries must themselves place their economies on a self-sustaining basis.” It recognizes that government economic controls have at least “in certain instances . . . hampered production and weakened the incentive to work.” It points out that in most countries today “the most important consideration is the termination . . . of domestic inflation.” It concedes, finally, that in at least some—unspecified—countries “an adjustment of the exchange rate may sooner or later be necessary.”

But in spite of these assertions, the main argument of the 124-page report is thrown heavily on the side of retaining overvalued exchange rates, keeping exchange controls, prolonging all the internal controls that this necessitates, and even “temporarily” tightening and extending such controls. In brief, the report on net balance supports not the philosophy of freedom but the philosophy of collectivist planning. Its recommendations, which in the main contradict those just mentioned, would not hasten world recovery but retard or prevent it. They would drain the American economy farther in an effort to support the insupportable.

The chief reason for the chronic European trade deficits that we are trying desperately to make up by ECA grants is precisely the overvaluation of European currencies through exchange control. But though the Fund's report admits that exchange-rate “adjustments” may be necessary “sooner or later,” it proceeds to offer all sorts of excuses for not making them now.

These excuses are often inconsistent. Thus on page 2 we are told that “by the end of 1947 nearly all the European countries had reached or exceeded their pre-war outputs.” But on page 8 we learn that “the capacity of these countries to export has been severely reduced.” On page 23 we are told that “so long as an exchange rate does not hamper a country's exports, there is little to be said in present world conditions for altering it.” Yet an excessive exchange rate must necessarily hamper a country's exports by overpricing its goods in foreign markets.

The Fund's standard ignores, moreover, the effect of an excessive exchange rate in unduly encouraging *imports*. Yet this consequence gets a sort of backdoor recognition on page 28, when the Fund declares: “Until the abnormal demand for imports can be checked by other means, some countries may have to use penalty rates of exchange for this purpose.” In other words, in order to defend an excessive exchange rate for exports, the Fund is forced to recommend a *different* exchange rate for imports. Yet it elsewhere professes to deplore precisely such “multiple currency practices.”

The Fund is alarmed by what it calls “premium prices” on gold. It wants an even more complete government suppression of private transactions in gold. Yet the real offense of gold “premium prices” is that they expose the fraudulence of existing official paper-money valuations.

The fact is that its basic premises drive the Fund to advocate not free enterprise but an international system of collectivist and coercive state “planning” as the only way to world recovery. On page 25 it declares flatly that “the fundamental conditions which would make possible the abandonment of trade and exchange restrictions are . . . entirely absent today in most of the world.”

The Fund complains about the inconvertibility of currencies, which has finally made it all but impossible for European countries to trade even with each other. But it never seems to occur to the authors of the report that inconvertibility is merely the inevitable consequences of preventing currencies from being bought and sold at their free-market rates. In a free market any currency could be converted at any amount into any other. In fact, it never occurs to the authors that the suppression of free markets—in currencies, exports,



imports, investment, domestic prices, and domestic trade—is the main cause of the present world economic crisis. ☸

## Cheap Money Causes Inflation

October 18, 1948

Artificially low interest rates are a direct and major cause of inflation. I tried to point this out in a previous article, “Cheap Money Means Inflation” (*Newsweek*, Dec. 8, 1947). But the proposition is frequently denied by government monetary managers who want to maintain cheap money for political purposes. Not until the causation is so well and so widely understood that it can no longer be successfully disputed will inflation be halted abroad or at home.

The interest rate is a price like any other. Free prices balance the supply of and demand for commodities. Free interest rates balance the supply of and demand for loanable capital. When government edict holds a commodity below its free market price, an increased amount of that commodity is demanded. Exactly the same thing happens with credit. Artificially low interest rates increase both the number of borrowers and the amount that each of them wants to borrow.

People are confused by some experiences that seem on the surface to contradict this. They point out that interest rates can sometimes fall almost to nothing and still fail to stimulate borrowing, and can at other times rise very high before they discourage borrowing. But this is simply because the demand for loanable funds is largely a derived demand. It is a *joint* demand with other things. Interest rates are merely part of a composite cost of production.

The case is no different in principle from the demand for bricks. When all other costs are too high in relation to the price at which new houses can be sold, brickmakers might not increase their sales even if they offered their bricks for next to nothing. On the other hand, a 100 percent increase in price of bricks might mean, say, less than a 10 percent increase in the overall cost of building. So in good times a sharp rise in the price of bricks alone might not appreciably cut down the demand for housing or the derived demand for bricks.

But on the supply side there is a profound difference between credit and commodities. An excessively low price cuts down the supply of a commodity because it cuts profits and drives marginal producers out of business. But the creation of new credit has practically no cost of production. When a bank makes a new loan to a customer, it simply enters a deposit credit on its

books for the amount. It creates new money with a stroke of the pen. Artificially low interest rates increase the demand for bank loans; increased bank loans mean increased bank deposits; increased deposits mean an increased volume of money; an increased volume of money means an increased monetary purchasing power pushing up the prices of goods. Cheap money means inflation.

Conversely, an accelerative increase in the creation of new credit and new money is necessary to keep interest rates down artificially.

This chain of causation is denied by our present monetary managers. Or rather, they admit its application to private credit, but not to government credit. They admit its application to the Federal Reserve member banks, but not to the Federal Reserve Banks themselves. Hence we have the preposterous situation in which the Federal Reserve authorities, in a “disinflationary” gesture, crack down on member-bank excess reserves under \$1,000,000,000 (near a minimum working level), while the Federal Reserve Banks themselves hold government securities of more than \$23,000,000,000. In the last year the Federal Reserve Banks have bought \$8,800,000,000 of government bonds, of which \$3,300,000,000 were bought in the last three months alone.

All this is the result of trying to hold down the interest yield on long-term government bonds to 2½ percent. As the Committee on Public Debt Policy declared in its final report last week: “Central banks and treasuries . . . cannot exercise controls over excessive credit expansion and at the same time keep money excessively cheap for government borrowing. When a Federal Reserve Bank buys government bonds to peg the price, Federal Reserve money flows out and increases the money supply. This is wholly inconsistent with the effort to fight inflation by reducing the money supply in other ways.” ☸

## Criptic Economics

October 25, 1948

Before the National Press Club in Washington on his recent visit, Sir Stafford Cripps, Britain’s Chancellor of the Exchequer, declared that the Labor government had “no idea whatever” of devaluing the pound sterling. He added that devaluation would “increase the price of our imports and decrease the price of exports, which is exactly the opposite of what we are trying to accomplish.” Later he explained that what he meant was that devaluation of the pound would swing the “terms of

trade" still farther against Britain and require a larger volume of exports to pay for its imports.

Even if Sir Stafford's theory of the exchanges were correct, his implied policy is hardly calculated to promote world revival. It treats an exchange rate not as something that reflects the real value of a currency, but as a weapon for exploiting other countries. The rate is to be manipulated so that the British can buy cheap and sell dear by forcing the rest of the world to sell cheap to and buy dear from Britain.

Sir Stafford's theories, however, happen to be wrong. A nation cannot alter the terms of trade in its favor merely by manipulating its exchange rate.

Let us look at the matter first from the side of imports. If wheat is selling here at \$2.16 a bushel, then a hundred bushels of wheat will cost the British \$216. With the pound pegged at \$4, they will cost the British buyer (ignoring subsidies) £54. If the pound fell to \$3, the same wheat, it is true, would cost the British buyer £72. But it would not cost the British any more in *dollars*. And what Britain now complains of is not a pound shortage but a dollar shortage. The British Government can print all the pounds it wants. One of its troubles is that it has already printed too many.

Now let us look at the matter from the side of exports. The British sell cloth in our market, say, at \$36 a bolt. At a \$4 pound, the British exporter gets £9 for it. But if the pound fell to \$3, the exporter would still be able to get \$36 a bolt here. Therefore he would get £12 a bolt instead of £9. His sterling profits from export, and his incentive to export, would be that much greater.

Sir Stafford's belief, therefore, that sterling devaluation would "increase the price of our imports and decrease the price of exports" is not true at all if we look at these prices in terms of dollars. And it is the supply of dollars about which the British bureaucrats are always complaining. If we look at these prices in terms of pounds, it is true that the price of Britain's imports would be greater in pounds, but the exact opposite of the truth that it would get fewer pounds for its exports. On the contrary, it would get more.

It is the insistence of the British Government on keeping the pound above its free market value that is chiefly responsible for the chronic British trade deficit. An overvalued pound unduly encourages imports both of necessities and of luxuries. This forces the British bureaucrats to hold down imports by license, quota, and prohibition. And where the overvalued pound does not force British exporters to price themselves out of foreign markets, it makes the profit margin on their foreign sales so unattractive as compared with what they could

get from domestic sales that the British Government has to *order* manufacturers to sell abroad, has to allocate goods for export, and has to forbid its own citizens from buying more British products than some arbitrary domestic allotment. Thus foreign trade is carried on by a series of compulsions on buyers and sellers, consumers and producers.

It is only Marshall-Plan aid that enables this system to keep going at all, by forcing the American taxpayer to pay for the trade deficit that the system creates. The European trade deficit could quickly be solved by free markets and free exchange rates, which would enormously stimulate exports at the same time as they would discourage imports. But most of the governments of Europe have no faith in free markets, do not understand their function, and will not permit them to operate. In addition, most European governments wish to conceal their inflations by holding down internal price levels by edict. ❁

## Texas Grows and Votes

November 1, 1948

DALLAS—Inside the American boom Texas has a super-boom. Inside the Texas super-boom is the Houston super-duper-boom. It has been on for a long time. A town of less than 2,400 population in 1850, and 385,000 in 1940, Houston claims 495,000 today. Since 1939 the number of its manufacturing plants has almost doubled and its industrial employment has more than trebled. Such growth is no flash in the pan. It is Manifest Destiny.

There are many reasons for the incredible prosperity and industrial expansion of Texas. The chief one is oil. This one state produces more than 44 percent of the nation's whole output of crude oil. It holds 55 percent of the nation's entire proven oil reserves. In fact, the Texas oil rush of 1948 is reminiscent of the California gold rush of 1849. The state seems crowded with millionaires who were broke a few years ago and then struck oil. One hears of a dozen men worth more than \$50,000,000 each, of half a dozen more worth more than \$100,000,000 each.

But such estimates, true or false, give a distorted overall picture. There are more than 100,000 oil wells in Texas, and new ones are being drilled at a rate of 10,000 a year. But thousands of these turn out to be dry holes. As in a lottery, one is apt to hear only about the winners. One hears little about the huge misdirection and waste of capital and labor in the quests for oil that fail. Yet more than four out of every five of the

wildcat wells drilled in Texas turn out to be dry. It is significant that the big companies are content to leave the gamble of exploration work largely to wildcatters and independents, and to buy the wells or fields after they have been proven.

But oil is only part of the Texas story. The state has a record cotton crop at high prices. It has been selling its cattle for record prices. It is the fastest growing center for chemical industries. It is a chief beneficiary of the decentralization of industry and of the new defense program. Everything seems to be working for Texas.

Politically the state is boiling. The Democrats are deeply and bitterly split. To the division between conservatives, States' Righters, and New Dealers has been added the feud between the supporters of former Gov. Coke Stevenson and of Rep. Lyndon B. Johnson that arose from the Senatorial primary race. In the run-off Johnson ran ahead of Stevenson by only 87 votes out of a total of 988,295. The vote turned in from some of "the valley" counties was deeply suspicious. Stevenson supporters have charged fraudulent voting and counting. Johnson and his lieutenants have opposed investigation. Stevenson himself, on the issue of honest elections, has thrown his support to the Republican Senatorial candidate, Jack Porter.

Some political experts believe that the total vote in the Texas Senatorial race will be bigger than in the Presidential, and that Porter may run ahead of Dewey and Warren. Johnson, however, is expected to win. A serious question may then arise whether the Senate will seat him. If the new Senate majority is Republican, or even more if the Republicans need a majority of one to organize, then it is believed that Johnson's right to a Senate seat will be challenged. So the Texas Senatorial imbroglio could have a decisive national consequence.

That Dewey can capture the Texas electoral vote is regarded by most observers as at best an outside possibility. The range of most guesses is that Truman will get between 50 and 60 percent of the popular vote, Dewey between 25 and 35 percent, Thurmond around 10 percent, and Wallace 3 to 5 percent. Even this, however, would be a remarkable Republican showing for Texas, and a still more remarkable anti-Democratic showing. For the first time on record prominent Texas newspapers, such as *The Houston Chronicle*, *The Houston Post*, and *The Dallas News*, have come out for the Republican ticket. Texas voters by the thousands are publicly and defiantly stripping off their life-long Democratic brass collars. One permanent result of the present revolt may be to make Texas a two-party state. ❁

## How Free Will Our Economy Be?

November 8, 1948

The democratic victory will have a crucial effect on the future freedom of the American economy. True, neither of the Presidential candidates supported what any of us would have called a free economy twenty years ago. And Governor Dewey, during the course of the campaign, supported farm parity prices, higher minimum wage rates and, by implication, government cheap money policies. But President Truman has gone farther. After the election of 1946 he steadily drifted in the direction of demanding further government controls, especially price fixing.

In trying to guess whether our future economy is likely to be "free" or not, it may help to clarify our ideas if we ask ourselves just how free our present economy actually is. All the rest of the world refers to us as a free economy, but, this is only a comparative term. If we assume, for purposes of definition (and not necessarily for endorsement), that a free economy would be one with no economic legislation except that embodied more or less in the common law against force, coercion, theft, fraud, and the enforcement of contracts, plus anti-monopoly legislation, we would find that we are already a remarkably controlled economy. We might divide present regulations and restrictions into three chief groups depending on the time of origin: (1) pre-New Deal regulations; (2) New Deal regulations; and (3) wartime controls.

Under pre-New Deal restrictions the main item would be the protective tariff. Others would be the ICC regulation of railroad rates; local regulation of public-utility rates; Federal Reserve and local banking requirements, and immigration restrictions.

Under the still retained New Deal regulations we would include: The Wagner Act (as modified by the Taft-Hartley amendment) which restricts the employer's right to hire, fire, promote, demote, bargain individually or collectively (but under the Taft-Hartley Act puts some corresponding obligations on unions). The Norris-LaGuardia Act, which prevents the employer from getting court injunctions in strikes (though this was passed in 1932). The Wage-Hour Act, which prescribes a minimum wage of 40 cents an hour and 50 percent overtime above 40 hours, thus in effect controlling nearly all wage earners. The elaborate set of rules and regulations by the Securities and Exchange Commission for publicity, for offering securities, etc. The laws breaking up public-utility-holding companies. The creation of TVA's with their government-subsidized competition with private utilities. The "parity"



payments and postwar price floors for agriculture products, together with the government loans and storage that these require. The social insurance laws with their accompanying taxes and record-keeping obligations; unemployment insurance; old-age and survivor's insurance; old-age and disability assistance, etc. The Robinson-Patman Act. Federal mortgage financing of housing.

Present controls which are in the main a holdover from the war include: Rent control. Steeply progressive income taxes; heavy corporation taxes; the development of the withholding tax. Export or import controls, requiring special licenses. Government-imposed stock speculation margin requirements; government grain-market regulations. Consumer installment-credit regulations. "Fair-employment-practice" acts in New York and other states, which prevent the employer from discriminating in employment on grounds of race, sex, color, religion, etc. Direct government purchase of grain for the foreign-aid program. The ECA itself. "Voluntary" allocations of scarce products. Artificial low-interest rates, and the government-bond-support program.

This rather haphazard inventory of the regulations already imposed shows how far we have come from the "free economy" of which we still boast. And certainly neither the arguments of Mr. Truman in the campaign nor its overall outcome are such as to encourage the hope that the tendency in the next four years will be toward a return to a free economy. On the contrary, the drive is toward more statism. ❁

## Where Was the Opposition?

November 15, 1948

It is Jules Verne, I think, who somewhere tells the story about how the inhabitants of the earth agreed that on a given night and minute they would all raise a mighty shout in unison, in the hope that this terrific noise would be heard on the moon. When the appointed night and moment arrived, there was an unprecedented silence. Everybody, out of curiosity, had decided to keep still so that he might be the one listener to this historic marvel.

Something like that seems to have happened on Nov. 2. The complete unanimity of the polls and predictions made many voters regard the election as a pre-ordained event that they personally could do nothing to determine. It was going to determine itself. So lukewarm supporters of Dewey stayed home, and others even gave President Truman, as the hopeless underdog,

a token vote of sympathy for his plucky fight—only to be astounded, on Wednesday morning, at the collective result of what they had done.

Speaking more seriously—though I think there is at least some truth in the foregoing explanation—it was Dewey, not Mr. Truman, who was the real victim of the opinion polls. Dewey believed in them and based his whole campaign strategy upon them. He assumed that he already had a comfortable and even overwhelming lead, that the way to hold it was simply not to make any mistakes, and that the way not to make any mistakes was not to take any stand that would cost him any of his supporters. The result was that he repeated tediously high-sounding truisms about national unity and that he failed to debate the merits of a single major issue. He avoided all the little errors only by making the one tremendous error that defeated him.

Never in our history has a candidate been offered a more tempting profusion of crucial issues to debate. Never did a candidate throw them all away as disdainfully and systematically as did Dewey. He never troubled to explain to the voters just why the President's Vinson appeasement gesture would have been so disastrous. He never hinted, except in the vaguest generalities, how he would halt inflation. On New Deal policies such as farm parity payments, social security, public housing, and Federal minimum wages he adopted a me-too attitude that many of his opponents thought was insincere and that many of his supporters hoped was insincere.

The outstanding example of his failure was the way he dealt with the Taft-Hartley Act. Here was a law passed by the overwhelming majority of Republicans in both Houses. The Republican Presidential candidate, therefore, was bound in the interest of his party to defend it. President Truman, moreover, was in an extremely vulnerable position on the act. A majority even of the Democrats in Congress had voted for it over his veto. None of his dreadful veto predictions about its consequences had been borne out by events. He had himself made use of its provisions repeatedly to combat major strikes.

Most of all, whatever its shortcomings, the Taft-Hartley Act was and is immensely superior to the Wagner Act that it displaced. It is not an "anti-labor" law but a pro-labor law. It protects the interests of the rank-and-file union member against the labor bosses. Mr. Truman blasted this law from beginning to end of his campaign. And Governor Dewey defended it with obvious reluctance, in a few apologetic sentences, chiefly emphasizing that it could be improved. Small wonder he was defeated on it.



Everybody is trying to figure why the polls were wrong. My guess is that they were probably right, as of the time they were taken, but that a sufficient number of voters (which did not have to mean more than three or four in every hundred) changed their minds in the last few days to reverse the result. With all respect to Mr. Truman's unflagging fight, this was mainly, I think, the final consequence of Dewey's say-nothing campaign.

The net result is that we are drifting into further inflation and collectivist planning by political default. ❁

## Pitfalls of Forecasting

November 22, 1948

From time to time readers of this column suggest that I should forecast the future of business—tell whether we are headed for a boom or a bust, and exactly when it will come, how high or deep it will go, and how long it will last. I have refrained from such crystal gazing. The fate of the political experts who predicted the certain election of Dewey will help to explain why.

The economic future, like the political future, will be determined by future human behavior and decisions. That is why it is uncertain. And in spite of the enormous and constantly growing literature on business cycles, business forecasting will never, any more than opinion polls, become an exact science.

The reasons for this ought to be clear. The future of business never depends on any single factor. It depends on a combination of countless factors. None of us is near enough to omniscience to keep track of them all and to give each its exact weight. The typical professional business forecaster tends to assume that he can make a chart of past price movements, past volume of sales, past wage payments, or whatnot, and somehow pull out of it automatically the answer to the future. We ought to have learned by this time that he can't. All statistics, even the most recent, necessarily refer to past situations. It is true that the past and the present, when carefully studied, can throw great light on future *probabilities*. That is how we must study them. But they can never tell us future certainties.

The factors from the past or present that we select to study are arbitrarily selected. To know even completely the situation about inventories, say, a few weeks ago, was not to know that Mr. Truman, and not Dewey, was going to be our next President. And to know completely the state of inventories today is not to know what Mr. Truman is now going to do, what Phil Murray is now going to advise or demand, what Stalin's next move will

be, or what will happen in Britain, France, or China. Yet such countless developments all go to determine the future state of business.

In brief, a full knowledge even of all business statistics put together cannot give the full answer to the business future. For the future of business is today affected even more by what happens "outside" of business than by what happens "inside."

There is one more reason why business forecasting is so hazardous. When astronomers calculate the orbit and appearance of a comet, their predictions do not influence the comet. In human affairs, on the other hand, predictions about the future influence that future and change that future. It may have been precisely because Dewey's political victory was so generally taken for granted that he was defeated. For it led him to make a disastrously wrong type of campaign and it led his supporters to relax their efforts.

In business, a general belief that there will be a rise in prices tends to bring about that rise. If, on the other hand, the business community were to become convinced that prices would be stable until next February and then start to break, it would start to act on that assumption *immediately*. Therefore the expected break would come not in February but right away. For what each of us is seeking as an individual consumer, speculator, or producer is not primarily to be right about the future but to be right sooner than anybody else. That is how exceptional gains are made. But that is something that can only be achieved exceptionally and individually, and not collectively.

I do not mean to disparage all efforts at business forecasting. All of us, no matter what our occupations, are forced constantly to make guesses about the future, and to act on them. We must try to make them as well informed as possible. But we will save ourselves from some of the worst jolts if we frankly recognize that our guesses are only guesses, and that we cannot reduce the human future to a scientific certainty. ❁

## Meat and the Price System

November 29, 1948

A few weeks ago, in Texas, I visited the stockyards at Fort Worth. A close-up view of a great cattle market like this throws a brilliant light on the function of free markets in our economy.

The market in meat is as competitive as a market can get. Cattle are raised on 80 percent of the farms of this country. This means some 4,500,000 separate

producers. This fact alone shows how silly were the leftist charges of a “producers’ strike” when meat ceilings were reimposed in the summer of 1946. And as meat in its finished form is bought by practically all the consumers of the nation, the frequent headlines about “buyers’ strikes” are equally silly.

There is virtually no possibility of collusive price fixing at either end, nor any evidence of monopolistic pricing in the middle. In 1947 the Big Four meat packers averaged only 1½ cents profit on every dollar of sales. The buyers for the big packers not only have to bid against each other and against the smaller packers, but against thousands of ranchmen and feed-lot owners. For only about half of the thousands of cattle that are poured into Fort Worth every day from motor trucks and freight cars are destined to go immediately to the slaughterhouse. A large part are bought for other ranges, and still another part for pen feeding and fattening.

And it is here that prices, and above all the relationships of prices to each other, play a most significant role. For whether steers are slaughtered or bought for further feeding, and whether for range feeding or pen feeding, depends on the relationship of the price obtainable for steers as meat to range costs and the price of feed. It is the present *relative* prices of meat in the butcher shops to meat on the hoof, of hogs to corn, of corn to hay and wheat, of hay and corn to steers, of steers to calves, hogs, and sheep, of the price of each of these to their expected future prices, and to the expected future prices of all the others—it is this incredibly intricate maze of relationships which determines how much corn and wheat will be planted, how many hogs will be raised, how many steers will be slaughtered now, how many held for further feeding, whether on ranges or in pens, for just how long, to just what weights, and so on.

It is not merely that the prices of corn and hogs and wheat and hay and steers are all tied to each other. The intimate connexity of prices run through the whole economy. It is the relation of the prices of thousands of different commodities to each other that determines the relative amounts produced of each of these commodities.

It is not surprising, in view of these intricate interrelationships, that government price fixing always upsets the balance of production. The real surprise would come if it did anything else. It takes, for example, about 10 bushels of corn to produce 100 pounds of hogs. Normally, in a free market, the prices of corn and hogs oscillate around a ratio at which (because of other costs) about 12 bushels of corn would buy 100 pounds of live hogs. The OPA price fixers forgot even this simple two-commodity ratio. If, through price-fixing, pork is

underpriced in relation to corn, or beef in relation to corn or grazing costs, a shortage of meat soon develops.

Yet free markets solve these and enormously more complicated problems of balance quasi-automatically through the price system. Small wonder that Friedrich A. Hayek, in his new book *Individualism and Economic Order*,\* declares that if the free-market mechanism had been the result of deliberate human invention, it “would have been acclaimed as one of the greatest triumphs of the human mind.”

That meat prices are actually not too high in relation to the enlarged monetary income of the country is clearly shown by the fact that the per capita consumption of meat in 1947 was 155 pounds, compared with an average of 126 pounds from 1935 to 1939.

\**Individualism and Economic Order*. By Friedrich A. Hayek (272 pages, University of Chicago Press, \$5). ⚙

## Exchange Control in Peru

December 6, 1948

LIMA, PERU—“Let observation with extensive view, survey mankind from China to Peru.” So wrote Samuel Johnson in the eighteenth century, and his advice is still good today, especially to a student of the world currency chaos. In China he can see what happens when inflation runs wild and when it takes many millions of the monetary unit to buy as much as one American dollar. And in Peru he can see what happens when an attempt is made to prevent the effects of inflation not by stopping its cause—the increase of money and credit—but by the strangulating device of exchange control.

This is not to imply that there is anything unique about inflation and exchange control in Peru. What is most instructive about Peruvian inflation and exchange control is precisely its typicality.

In a small country like this—with a relatively simple economy almost wholly dependent on foreign trade, a country that must import or die and export or die—the effects of exchange control stand out in startling relief. It has been the subject of daily battles carried on in clamorous headlines between the two leading Lima newspapers. All over its front page, with charts, statistics, and letters from exporters, *La Prensa* demands the abolition of exchange control while *El Comercio*, supporting the importers, demands that “the dollar must be held at 6.50 soles.”

The Peruvian crisis is instructive above all for the light it throws on the so-called world dollar shortage.

European beneficiaries of the Marshall Plan have convinced American officialdom that their dollar shortage is the result of the destruction and dislocation of the war. But Latin American experience serves to remind us that any nation can have a dollar shortage and that an overvalued currency supported by exchange control is the certain way to get it.

The official rate for the sol is 6.50 to the dollar. This official rate has been retained in spite of mounting internal inflation. In August this year the total money supply in Peru was about five times the supply in 1940. Yet the 1947 physical output of Peru was in most products below 1940. The result is reflected in a rise in living costs by this September to 379 percent of the 1934–36 level and in wholesale prices to 437 percent of that level.

Even these figures understate the rise. For since January this year government authorities have been calculating the index number on the basis of official price ceilings and not on actual prices prevailing in the free or black market. In the legal free market here the sol has been selling around fifteen to the dollar. Until this September, however, exporters, with the exception of exporters of gold bars, were required to turn over to the government all their dollar exchange receipts at the official 6.50. By a decree of Sept. 6 exporters were required to turn over to the government after export taxes only 65 percent of their dollar receipts at the 6.50 rate. They were allowed to keep “exchange certificates” for the remaining 35 percent which they could use for imports or sell in the open market for about fifteen soles to the dollar. Even with this partial relief exporters have been squeezed between mounting domestic costs and the requirement to sell most of their dollars to the government, in effect at 40 cents apiece.

The result has been inevitable. In spite of a record world price for most of Peru’s exports—consisting chiefly of cotton, sugar, petroleum, copper, lead, zinc, silver, and gold and record exports measured in soles, many of Peru’s chief exports have been declining in actual quantities. Because of this and the abnormal incentive given to imports by the overvalued sol (i.e., by the privilege of buying the dollar at 40 cents), Peru has managed in 1947 to achieve the first unfavorable balance of trade in its history.

Exchange control has intensified the very dollar shortage it was designed to cure. It has been dislocating and strangling Peruvian production. This is the background of the present agitation for return to a free-exchange system. ❁

## Exchange Control vs. Peru

December 13, 1948

LIMA, PERU—Gen. Manuel A. Odria, the new President of Peru who took power by a military coup Oct. 29, is a short man. But he has dignity and poise and gives an impression of strength. In the course of an interview he granted me I was also struck by a quality one would hardly expect in a man who had just come to power by revolutionary means—caution. This was particularly evident in his reply to my question about his policy on exchange control.

There are two schools of thought in Peru, he answered. One is in favor of keeping controls and one is in favor of abolishing them. “The government,” he declared cryptically, “has chosen the path that is best for the economy.”

The *new exchange decree* of Dec. 4 is a half-hearted compromise between the Bustamante decree and free exchanges. It will allow the exporter to retain 55 instead of 35 percent of his dollar receipts in certificates that he can sell in the free market; but he must still turn over 45 (instead of the previous 65) percent of his dollar receipts to the government at the official rate of 6.50 soles. Whatever relief this brings will be more than offset by the new decree forcing employers to give workers a 30 percent share in profits.

Free prices, free interest rates, and free exchange rates are the traditional way of preserving or restoring the trade balance between nations. Exchange control with the overvalued Peruvian sol has reversed the normal price incentives. It has systematically discouraged exports and encouraged imports. To compel an exporter to surrender most of the dollars he earns for 6.50 soles apiece instead of allowing him to get the market rate of about 15 soles is a way of imposing a huge concealed tax on the exporter in addition to the very heavy open tax on exports from Peru.

In metal mines this huge double tax has prevented the working of marginal ores and halted exploration and development. It has been primarily responsible for a falling acreage and production of cotton, Peru’s greatest single source of dollars. On the other hand, when the market rate for the sol is about 15 to the dollar, a license to import at the 6.50 rate is a huge but disguised subsidy to the importer.

This totalitarian system gives the government life-and-death powers over individual concerns. When administered by modestly paid minor officials who have discretionary power to grant or withhold import licenses, or even to expedite or delay them, and when the decisions of such minor officials may make a



difference of millions of soles to an individual business concern, the emergence of wholesale bribery and corruption becomes inevitable.

This corruption spreads through the business community. There has been a flourishing black market in import licenses. There has been a rapid growth in the practice of fraudulent or double invoicing.

Nor has exchange control in Peru helped the consumer. Only a totalitarian and completely effective system of price control straight up to the retail level could do this. As things are, with few exceptions the benefits of the 6.50 import rate go merely to increase the profit margin of the favored importer, wholesaler, or retailer—who bases his selling price not on the cost to him but on short local supply and inflated domestic monetary demand.

Not only in Peru but everywhere, exchange control with an overvalued currency is a concealed tax on exporters to pay a disguised subsidy to the importers. It rests on the assumption that the producer can with impunity be forced to subsidize the consumer; that the volume of exports is practically automatic regardless of the monetary incentives or discouragements to it, and that the amount of available foreign exchange is rigidly fixed regardless of government policies.

All these assumptions are false. Peruvian experience underlines their falsity. You cannot penalize the producer and exporter without drying up the very stream of foreign-exchange receipts upon which the importer and the consumer depend. ❀

## The Myth of Dollar Shortage

December 20, 1948

Over the last two years this column has constantly returned to the theme that the so-called world dollar shortage is a myth; that it is merely another name for the effort of most countries to live beyond their means; and that the alleged shortage results directly from the insistence of foreign countries on maintaining an excessive valuation for their currencies by the totalitarian device of exchange control. This was the burden of my columns of Aug. 18 and Sept. 22, 1947, of May 10 and Aug. 16, 1948, and those in the last two weeks from Peru.

Yet there is hardly a finance minister in the world who acknowledges this truth publicly. The International Monetary Fund admits it only in a timid, left-handed, and inconsistent way. Those in charge of our ECA do not even seem to know that they are using American dollars mainly to prolong and subsidize the very system

of exchange control and the very overvaluations that impede world recovery and lead toward further chaos in world trade. And the professors of economic theory, from whom one might hope for intellectual leadership in these matters, pile up a thousand subtleties, qualifications, and distinctions and end by understanding everything, in fact, but the main point.

It is consoling, in all this, to find a few honorable exceptions. Here, Ludwig von Mises has always seen the matter clearly. So has Wilhelm Röpke in Switzerland. In October a year ago Roy Harrod of Oxford had the courage to declare in his pamphlet "Are These Hardships Necessary?" that the "dollar famine" is "one of the most absurd phrases ever coined," and that: "This allegation of a world 'dollar shortage' is surely one of the most brazen pieces of collective effrontery that has ever been uttered."

And now, by his contribution "Dollar Shortage?" to a symposium published by the Harvard University Press,\* we must add the name of Gottfried Haberler. Dr. Haberler is the author of "The Theory of International Trade." He is an economist of world reputation and was appointed by the League of Nations to make a study of business cycles, first published in 1936.

Some readers may recall that in a column entitled "Dollar Shortage Forever" on Aug. 16, I tried to explain why the dollar-shortage theory of the distinguished London Economist was nonsense. I am happy to find this judgment confirmed by Dr. Haberler. He quotes this from *The Economist* of as long ago as Dec. 4, 1943:

"It may be, in fact, that the [dollar] problem . . . should be looked upon as the result of a set of economic circumstances never contemplated by the textbooks—namely, the existence of a country [the U. S.] which, all policy apart, needs so little from the rest of the world, while the rest of the world requires so much from it, that an equilibrium of accounts can be brought about by no means available to a free or even a tolerably free market."

Dr. Haberler calls this doctrine "entirely fallacious." "Evidently," he continues, "even in the land of Adam Smith, Ricardo, Marshall, and Keynes it is necessary to point out again and again that trade is governed by comparative not by absolute cost!" The theory that the United States will out-compete and undersell the rest of the world all along the line, he observes, is "high praise for the productive power of capitalism and free enterprise. But the economics is unacceptable nonetheless!"

Regarding the failure of the shortlived sterling convertibility experiment in the summer of 1947, he points out that: "In a state of repressed inflation with a fancy exchange rate, convertibility could not work. . . . Far



from disproving the classical theory of international trade, the failure of convertibility could have been deduced in advance from the most elementary principles of classical or even preclassical (Sir Thomas Gresham, 1519–1579) economics.”

\* *Foreign Economic Policy for the United States*. Edited by Seymour E. Harris (490 pages. \$6). ⚙

## Are Profits Too High?

December 27, 1948

Congressional leaders are planning a new boost in corporate taxes. They seem to be divided only concerning whether this should take the form of an increase in the regular corporate tax rate or an “excess-profits” tax. Few voices are being raised to point out that either type of increase now would retard future American production. Corporate taxes are already harmfully high. They represent a form of double income taxation that directly discourages venture capital and industrial growth.

In dollar terms, present corporation profits seem high. Labor leaders charge that the corporations are “gouging” the public. But all this is simply a consequence of monetary inflation. As Keynes pointed out 28 years ago (see my column “Lenin Was Right,” Sept. 22, 1947), when the currency unit is debased by governmental policy high corporate profits “are a consequence and not a cause of rising prices.”

Moreover, the profits resulting from inflation are in large part illusory. In my column of Oct. 25, 1947, I pointed out that they were being greatly exaggerated, because sufficient allowance was not made either for unreal inventory profits, for inadequate depreciation charges, or for the shrunken purchasing power of final net dollar profits even after these had been correctly calculated.

The illusory nature of the profits resulting from inflation is no sudden new discovery, even though only a few are just becoming aware of it in this country. It was clearly pointed out by the Austrian economist Carl Menger as early as 1892. But from the recent hearings before a Congressional committee we are indebted to two economists, Sumner H. Slichter of Harvard and

William A. Paton of the University of Michigan, for powerful restatement of the point.

“During the last three years,” Professor Slichter calculates, “American corporations have overstated their profits by approximately \$16,400,000,000. This is the amount by which the reported statements of profits exaggerate the amount of income available to pay dividends, to expand plant, to increase wages, or to reduce prices.” While reported profits for 1948 will be between \$20,000,000,000 and \$21,000,000,000, Slichter estimates that real profits will be only about \$16,000,000,000.

These wide discrepancies between real and reported profits come from two principal inaccuracies. “One arises from the fact that most corporations still insist on counting a rise in the cost of replacing inventories as profits. The other is that more corporations count the rise in the cost of replacing plant and equipment as profits. It is obviously ridiculous to count a rise in costs as profits and yet most corporations do it, and pay stiff taxes on the amount so reported.”

Are profits “excessive”? “The answer to this question depends upon how fast the community wishes industry to expand. If profits are causing industry to expand faster than the community would like to have it expand, they are excessive. If profits fail to bring as rapid an expansion of productive capacity as the community would like to have, profits are inadequate.”

Not merely present but prospective profits, in short, must be great enough to “induce the investment of capital at the present cost of construction and at the present prices of equipment.” This inducement, so far as the American public is concerned, doesn’t seem to be very great. In 1946, 1947, and the first half of 1948 “less than one-tenth of all personal savings went into corporate securities.” New financing through issue of common stocks has only been a trickle for years. This situation, as Professor Paton comments, “does not suggest that now is the time to try to pick a little more meat from the stockholder’s bones.”

On the contrary, it suggests that by overreaching themselves now, both labor leaders and our taxing authorities will retard the capital investment upon which the country depends to provide new factories and tools, to increase future real wages, and to enlarge future government revenues. ⚙

1949



## We Impose Collectivism

January 3, 1949

The White Paper on the British Government's four-year recovery program is significant not only for what it tells about that government's policies but for what it tells about our own. The Marshall Plan was put forward as a plan to combat Communism by helping the world to return to free enterprise. By almost imperceptible stages this objective has been reversed. We now insist that no country can get financial aid from us unless it rejects free enterprise in favor of government planning and collectivist controls.

This startling transformation has come about not by anybody's conscious plot. It has come about because the basic assumptions of those in charge of the EGA are unconsciously collectivist.

The British White Paper makes this clear. The "general framework" of its four-year plan, it points out, "was one prescribed by OEEC [Organization for European Economic Cooperation] for all its members." Last August "each member country was invited [by the OEEC] to prepare a statement showing how it proposed to reach the objective" of restoring "a satisfactory level of economic activity." In asking for this the OEEC was in effect asking for a government plan. In asking for a government plan it was in effect asking for the suppression of free markets and free enterprise.

For government planning means central control. Where you have central control you cannot at the same time have private or individual control. One excludes the other. If the government is going to say exactly how much steel, coal, oil, electricity, chemicals, and textiles are going to be produced in the next four years, then individual firms cannot make their own decisions on how much they are going to produce of these things. If the government is going to plan just how great imports and exports and the trade deficit are going to be four years from now (a palpable absurdity anyway), then these things are not going to be left to the play of market forces.

Suppose, in reply to our demand for its "program" for economic recovery in the next four years, one European government had had the courage and intelligence to reply simply: "Our program is to restore a free economy," period. In all likelihood the EGA would have told that country that this was no program at all—that it was (in the fashionable patter of the moment) merely a proposal "to sit idly by and do nothing."

Yet what is America's four-year production plan? Unless something is just about to be sprung on us. "America," unlike "England" and "France," has no

plan at all. True, General Motors, United States Steel, the firms making television sets, the wheat grower in Kansas, the drugstore owner on Main Street have their own individual plan. So do most consumers—the family planning to build a home, to buy a car or a washing machine. But an overall government plan displaces such individual plans. In Britain the industrialists are told who is going to be allowed how much to expand what. The consumers are told how much of what they will be allowed to buy. The workers are told where and at what they can work. These four-year plans are obviously inspired by Russia's five-year plans, paying Communism the sincerest flattery of imitation. And they are now being imposed by us on the Marshall-Plan nations under the pretense that we are not "interfering" in their economies at all. But when our officials are asked to insist on the conditions that would really bring recovery, such as the restoration of free exchanges and free markets, they reply that this would constitute "interference." They dare not recommend a free economy for Europe, but they insist on continued collectivist planning.

As a result, the official summary of the British White Paper contains not a single word about the real cause of the British and the general European trade deficit. That cause is exchange control. Europe will continue to be "short" of dollars just as long as Europeans are not permitted to pay the real market price for dollars. ❁

## Rent Control in France

January 10, 1949

In this column of Feb. 2, 1948, I cited the rent-control situation in France as an example of the future we ourselves are heading for unless we begin quickly to work our way back to freedom. The Foundation for Economic Education at Irvington, N. Y., has now published a pamphlet by an eminent French writer, Bertrand de Jouvenel, explaining in detail the situation to which rent control in France has led. Here are his main facts:

A dollar a month will pay a wage earner's rent in Paris. (All figures are stated in dollars at roughly 300 francs to the dollar.) Rent on the average makes up 1.4 percent of the French wage earner's expenses. A month's rent for a family of six costs no more than eleven packages of cigarettes. Even rents paid by important officials or executives are no more than \$4 to \$10 a month. Parisians spend on shows every month far more than they pay for three months' rent.



This may seem desirable for tenants lucky enough to be in possession. Those in search of lodgings, however, cannot legally find them at any price. There are no vacancies. Deaths are the only opportunity. Tottering old people out to sun themselves in public gardens will be shadowed back to their flat by an eager young wife who will strike a bargain with the janitor to be warned first when the death occurs. Buying one's way into an apartment costs anywhere from \$500 to \$1,500 a room.

As a result of these fantastically low rents no new lodgings are being built. Practically none have been built, in fact, for the last twelve years. Of the 84,000 buildings for habitation in Paris, 27 percent are more than 98 years old. Almost 90 percent were built before the first world war.

Even a very lenient officialdom estimates that there are about 16,000 buildings in such disrepair that there is nothing else to do but pull them down. A fifth of the Paris population does not even have running water in their lodgings. More than half the population must go out of their lodgings to find a lavatory. More than four-fifths of the population have no bath or shower. Disrepair constantly increases. Owners are not in a financial position to allow them to keep up their buildings, let alone improve them. Their expenses commonly exceed their income. In fact, while rents since 1914 have been at the outside multiplied less than seven times, taxes have been multiplied thirteen times and the cost of repairs has been multiplied from 120 to 150 times. "An outsider," comments M. de Jouvenel, "may be tempted to think that only an incredible amount of folly can have led us to this. But it is not so. We got there by easy, almost unnoticed stages, slipping down the gentle slope of rent control." A fantastically complicated new rent law went into effect the first of this year, but it is unlikely to change the basic situation.

New houses put up in France today are legally free from rent ceilings. Why aren't they being built? There are two main reasons. New apartments would have to rent for prices representing from ten to thirteen times present rent ceilings, in order to repay the costs of construction and reward the capital invested. But it would be psychologically impossible to find customers at these rents, when it is still possible for them to double up (at great inconvenience, of course) at less than one tenth these figures.

Moreover, those who had been foolish enough to trust the government before the second world war by putting up new apartments exempted from the then-existing rent control now find these buildings also subject to rent ceilings. They are not allowed to get in terms of real income a tenth of what they got in 1939.

Prospective housing investors have no assurance that they will not be fooled again.

In sum, such is now the spread between the legal and the economic price of lodgings in France that "even the most fervent advocates of freedom are scared at the prospect of a return to freedom. . . . Rent control is self-perpetuating and culminates in both the physical ruin of housing and the legal dispossession of the owners. . . . The havoc wrought here is not the work of the enemy but of our own measures." ❁

## Paradise on a Platter

January 17, 1949

If there is anything any of us ever dreamed of having that Mr. Truman did not demand in his message to Congress it must have been an oversight. He called for more highways, more electric power, more reclamation, an increase of 87½ percent in minimum wages, "parity" income for farmers, more farm storage space, more rural electrification, more TVA's, more irrigation, bigger social-security benefits, prepaid-medical insurance, more doctors, more hospitals, more nurses, more teachers, more schools, more low-rent public housing, more slum clearance, more farm housing, and also more foreign aid.

What is astonishing, given his premises, is that he stopped where he did. If we are regularly to make a present to millions of people of all or part of their housing and food, why not also their furniture and clothing, stoves and refrigerators, shoes and overcoats, books and musical instruments?

"The number of low-rent public housing units provided for in the legislation should be increased to 1,000,000 units in the next seven years," declares Mr. Truman. But then he adds: "Even this number of units will not begin to meet our need for new housing." If it won't, why not increase it to the number that will? Isn't it simply a matter of raising a figure in a law? And won't the only opponents of this increase be the "selfish interests" and "the privileged few"?

And why increase the minimum wage only to a niggardly 75 cents an hour? Why not \$1, \$2, \$5 an hour? Or why not simply pass a law that people must be paid enough to buy whatever they happen to need? Then we could skip all the rest of Mr. Truman's giveaway program.

Once upon a time, when programs of this sort were proposed (though on a far less grandiose and imaginative scale), a few men of little faith used to inquire timidly where the money was coming from. Such questions

are now laughingly waved aside with the simple answer that we will put more taxes on the big corporations or on the rich, or with the still simpler answer that the government can *print* the money.

We cannot, in fact, understand what the catch is in all such glittering handout programs unless we pass beyond the monetary veil to the underlying realities. And the chief underlying reality is that we cannot distribute more than we produce. Total production, even American production, is limited. Even Mr. Truman pointed out correctly that "our production is still not large enough to satisfy our demands." Now it is private enterprise, not government, that produces. The government cannot give anything to A without first or ultimately taking it from B. And this is the elementary truth that Mr. Truman's supersonic New Dealism blandly ignores.

Mr. Truman asks, for example, for "prompt Federal financial aid to the states." The Federal government, of course, has nothing to give to the states that it doesn't first of all take from the people of the states. Mr. Truman insists on artificial price supports for farm products. This means that city workers will be forced to pay higher prices for their food. He insists on higher minimum wages. This means higher production costs. It means that workers will be forced to pay higher prices for industrial products. It means eventual unemployment.

Mr. Truman does not see that all his demands compete with each other. We cannot have more of everything unless we produce more of everything. Other things being equal, we can have more hospitals only at the cost of fewer highways, or more foreign aid only at the cost of fewer farm houses.

The government can pile benefits on A only by taking them from B. In doing this it will further undermine the production incentives of both A and B. For A will get something without working for it and B will have more taken from him no matter how hard he works.

Mr. Truman's program, in short, will mean not more for all of us but less for all of us. ❁

## Balance Whose Budget?

January 24, 1949

In the fourth year of peace, the President proposes to spend some \$42,000,000,000. This is equal to the amount spent in the entire five peacetime years from 1935 to 1939 inclusive. And few people ventured to

describe those Roosevelt spending years as models of economy at the time.

For national-defense spending alone, not counting foreign aid, Mr. Truman wants nearly \$16,000,000,000. This is more than was spent in the entire eighteen-year period from 1922 through 1939. And during nearly half of those years we faced an aggressive Japan and an ever more menacing Germany.

Such comparisons cannot be dismissed with the easy assertion that things cost more now. The Federal budget is a constantly mounting percentage even of our inflated national income.

The real comparisons are even graver. For when the operations of social-security trust funds are included, as they should be (because they involve compulsory tax payments), the proposed annual expenditures are not \$42,000,000,000 but \$46,000,000,000. Nor does the President's budget include any allowance for military lend-lease, though he nevertheless declares that he expects "later to request funds" for this.

Apologists for this budget are already falling back on the familiar technique of trying to silence its critics by asking rhetorically: "Where would you cut?" Behind this taunt is the implicit assumption that the burden of proof is on those who wish to economize. The burden of proof, on the contrary, must be placed for each item squarely on the shoulders of those who demand the expenditures. And it is not enough for them to prove, even if they could do so, that everything that these expenditures will buy is "needed." They must prove that the citizens of the country need each of these things even more than they need the things for which they would spend their own money if it were not taken away from them in taxes.

It is precisely this that Mr. Truman's economic philosophy overlooks. He wants the government to meet this "need" and that "need." He tacitly assumes that everything the government pays out is a net addition toward meeting these "needs." It is nothing of the kind. It is merely a substitution. At best it meets one need only at the cost of making it impossible to meet some other need. The government has not a dollar to hand to A that it does not take from B, or perhaps from A himself. Mr. Truman assumes that A must be protected against his own improvidence and that B must be compelled to use part or most of his earnings to support A's family instead of his own.

When Mr. Truman demands all sorts of government giveaway programs, and proposes to meet the added expense mainly by even higher taxes on corporations, he is in effect saying that our need for these giveaways is far greater than our need to improve our

industrial plant, equipment, and tools to increase workers productivity, real wages, and the future production of the country.

It is not surprising that his program is riddled with internal contradictions. He wants, for example, to impose still heavier taxes on the steel companies. This will still further reduce their incentive for reinvestment in plant and leave them even less funds for such reinvestment. Then he declares that the need for more steel is so imperative that the government itself must build the plants that the steel companies are discouraged or prevented from building.

He regularly insists that the Federal budget must be balanced to avoid inflation. But he wants to do this not by smaller but by larger expenditures, which can be balanced only by still greater taxation. He can balance such a Federal budget only by an unprecedented peacetime drain on the budgets of all the rest of us. By destroying incentives and preventing capital accumulation, he will reduce the volume of production to be shared among everybody. ❁

## Our Discompensated Economy

January 31, 1949

The three bulky documents that President Truman dropped on the new Congress—the annual message, the budget, and the economic report—all preached the same philosophy and made substantially the same recommendations. But of them all the economic report perhaps most clearly revealed the out-and-out statist philosophy that the President has now adopted. In it, as in his other messages, he continued to give lip service to “our system of private enterprise.” But every recommendation he made (except, say, those for the renewal of the reciprocal-trade agreements and the repeal of the oleomargarine tax) revealed complete lack of trust in the ability of that system to provide a balanced, orderly, and expanding production.

Our future, he said, must not be left to “chance”—by which he meant that it must not be left to free enterprise. No favorable outcome, he continued, will be realized “automatically”—by which he meant that it will not be realized by the self-adjusting processes of free markets. Far from recognizing the role of speculation in reducing price fluctuations, he blamed it for the fluctuations that have taken place. Throughout he demanded “positive” and “affirmative” action—which turned out to mean continuous government intervention in the economic process at every stage and at every point.

Mr. Truman assumed, in brief, not only that bureaucrats know better than the market what the general level of prices ought to be, but that they know better than the market what the relative price of one commodity should be to that of another, what the relative production of each commodity (e.g., steel) ought to be, exactly how high wages, interest, and profits ought to be, and what the proportion ought to be of consumer expenditures to investment expenditures. Last year industry, deducting inadequate depreciation charges, and at the peak of an inflation, reported an average profit of about 5 cents on every dollar of sales. Yet Mr. Truman does not hesitate to say that these profits “are in excess of the levels needed to furnish incentives and equity funds for industrial expansion.” What are the grounds for this *ipse dixit*? The extreme difficulty in recent years of raising new equity capital through the sale of common stock is surely not one of them.

But perhaps what is most disturbing of all in the President’s economic report is his refusal to deal seriously with the problem of inflation, or to recognize that it is primarily the government’s own policies that have been responsible for inflation. On the contrary, he not only defends but insists upon the continuance of the most inflationary policy now being followed—the monetization of the public debt through government bond pegging. This inflationary course is actually praised as a “contribution to the stability of the economy.”

The present situation underlines one of the fallacies behind the long-held New Deal theory of a “compensated economy.” The apostles of this theory insisted that it was the function of government to stabilize the national economy by spending heavily in times of depression and economizing or paying off debt in times of inflation. But even if the “compensated-economy” theory were not confused economically, it is completely unrealistic politically. For it fails to recognize that while nearly every government in power will seize upon any excuse to inflate in times of depression, it will almost never have the courage to deflate, or even to stop inflating, in the midst of an inflationary boom. No officeholder wants to assume responsibility for bringing a boom to a halt. Mr. Truman and his economic advisers today, while paying lip service to the idea of fighting inflation, constantly muddy the waters by pretending that there is an equal danger of deflation. So they advocate, at the top of the present boom, an unparalleled peacetime inflationary spending program.

The “compensated economy,” in practice, turns out to be not merely an uncompensated but a discompensated economy, in which the government itself does most to load the scales still further on the inflationary side. ❁



## Planned Unemployment

February 7, 1949

Administration forces are all set to drive through an amendment to the Fair Labor Standards Act boosting the national minimum wage from 40 cents an hour to 75. They have even provided for a further administrative boost of the legal minimum to \$1 an hour in selected industries.

They are now convinced that they can cure any economic deficiency whatever simply by forbidding it. Wages stand today in this country at the highest levels they have ever reached anywhere on the globe or in the entire history of mankind. But we are about to pass a law to compel them to be higher. Few have the courage to question this proposal. Who wants to be accused of favoring poverty and low wages?

Yet the question to be asked of this proposal is not how good are the intentions of its sponsors, but what will be its effect? Its first effect will be a boost in costs of production all along the line. It will mean an overnight increase in the minimum wage of no less than 87½ percent, and in industries where the \$1 minimum is ordered, of no less than 150 percent. Nor will this increase be confined to the part of the labor force now getting less than the new minimums. For other workers will demand the maintenance of their existing differentials. The result must be upward pressure on all wage rates.

One of two results must follow. Marginal firms will find that they cannot afford the higher costs. They will be forced to drop their marginal workers or go out of business entirely. In that case the main result will be shrinking production and growing unemployment. Or the government will resort to still further monetary inflation, in order to enable industry to pay the higher wage rates. In that case the higher money wages will be offset by price increases and will therefore be illusory.

The new minimum-wage proposal ignores the existence and function of geographic wage differentials. It will act as a protective tariff for Northern industry against Southern. It will encourage the concentration of industry by driving it from the South to the North and from the small towns to the big cities.

Yet the Administration is set to force these changes through Congress without adequate study or debate. It seems too much even to hope that in doing so it will repeal the Walsh-Healey Act (which is simply a duplicate minimum-wage law with different standards) or that it will repeal the biggest joker in the existing wage-hour law. This joker is the provision that the employer must pay a 50 percent penalty rate for all

hours above 40 a week, *no matter what his regular rate of pay.*

Under this provision a law ostensibly passed to apply only to marginal workers and their employers controls in practice the wages of nearly all the workers of the country. Out of this provision have sprung all the disruptive portal-to-portal and overtime-on-overtime rulings. The provision penalizes most the employers who are already paying most. It rewards most the workers who are already best off. Under it the employer who pays his workers 40 cents an hour need pay only 20 cents additional for overtime. But the employer who pays his workers \$1.90 an hour must pay 95 cents an hour additional for overtime.

The cure for this absurdity would be simple. Those who insist on boosting the regular minimum-wage rate to 75 cents an hour could at least agree to fix the overtime minimum wage rate above 40 hours at \$1.12½ an hour. Then both workers and employers would be free to negotiate higher regular or higher overtime wages by individual or collective bargaining.

But it is visionary to expect that the Federal bureaucracy would now agree to *reduce* the scope of its meddling at any point or consent to throw *fewer* monkey wrenches into our economic machinery. For every employer must be kept in constant fear of the Federal officeholders, no matter what he pays, and every worker must be made to feel that his welfare is dependent upon governmental favor. ❁

## ‘Planning’—Ah! Magic Word

February 14, 1949

Few speeches of Mr. Truman’s have revealed as much confusion of thought as his plea before the National Planning Association for a planned economy. He began by making a distinction, which he did not clarify, between a “planned” economy and a “controlled” economy. He implied that a “controlled” economy was totalitarian but a “planned” economy was democratic and free. The distinction is, in fact, purely verbal and semantic. Fundamentally government planning and government control are two words for the same thing. If anything, “control” implies less government in the economy than “planning.”

“I have been interested in planning,” said Mr. Truman, “all my life . . . ever since I was old enough to understand what the word meant. You know that *we* plan *our* day’s work. *We* plan the houses in which *we* are going to live. . . . But when *we* talk about planning



the things *we* want to do economically *we* are charged with being Communists and fellow travelers.”

The italics are mine. They call attention to the fact, of which Mr. Truman seems blissfully unaware, that the “we” in his last sentence is a radically different “we” from that in his preceding sentences. When he says that “we” plan our day’s work or our houses, he means that each of us plans his own day’s work or his own house. When he talks about planning the things “we” want to do economically he means the things that the *government* wants to do—the things that he wants to do.

In making a false distinction Mr. Truman misses the real and vital one. The distinction is not at all between what we want to do “economically” and what we want to do in other ways. To plan your own day’s work or your own house is to plan economically. Nor is the real distinction one between planning and not planning—though it is this confusion that the government planners have chiefly exploited. The real question involved is whose planning.

Who is to plan and for whom? Is each of us to be allowed to plan his own day’s work? Or are bureaucrats to plan it for him? Is each of 2,000,000 large and small business managers to decide what product he is going to make, and how much of it, and how? Or is the government (in the person, say, of Secretary Sawyer) going to tell each of them what to make, and how much of it, and in what way, and at what price? Is each of 6,000,000 farm operators to decide what he shall plant and how much? Or is Secretary Brannan going to tell him? Is each worker going to be allowed to work where he pleases? Or will Secretary Tobin direct labor? Is each consumer going to buy what he wants? Or only what some bureaucrat thinks is good for him?

Anyone who thinks these questions are not real need look no farther than England, where the government decides (partly on American ECA insistence) how much of each product is to be produced in the next three or four years: what its citizens are permitted to import, and from what country; what prices they are permitted to ask or pay for domestic products or for foreign currencies; where and at what workers may take jobs and how much of what consumers are permitted to buy. *That* is what is meant by this euphemism “planning.” It is a simple denial of free markets, of free enterprise, of economic freedom.

All this was most compactly stated by the British economist Lionel Robbins in his book *The Great Depression*, published fifteen years ago; “Socialism is a term which is not universally popular. But ‘planning’—ah! magic word—who would not plan? . . . But if it were to be true to its name, it could not acknowledge the

substance of ownership, the right of individual disposal of the actual instruments of production. For ‘planning’ involves central control. And central control excludes the right of individual disposal. Nothing but intellectual confusion can result from a failure to realize that Planning and Socialism are fundamentally the same. Now the leaders of opinion want planning.” ❁

## ‘Me Too—But Not as Much’

February 21, 1949

Governor Dewey’s Lincoln Day speech in Washington underlined one major reason why he was twice defeated for the Presidency. It is his lack of a coherent political and economic philosophy, his lack of great convictions on great issues. Many voters complained during the campaign that they did not know where Dewey stood. As the campaign wore on, their perplexity turned to misgiving. He started as a sure winner. By the second of October he had defeated the prospects of a Republican Congress, and by the second of November he had defeated even himself.

Now that he has spoken again, it is harder than ever to tell where he stands. He begins by asserting that “the Republican Party is split wide open.” (Such an announcement, on the part of the “titular head,” is certainly the way to split it wide open or to widen any split.) He goes on to picture the party as consisting on one side of extremists against all “progress” and on the other side of extremists “who seem to embrace the entire New Deal and want to go far beyond it. . . . Both courses are fatal to our party.” What he fails to see is that the most fatal course of all is precisely the sort of “middle road” he recommends—one in which the Republicans accept the basic premises of the New Deal but allow themselves to be outbid in their application.

Surely he should have learned this from the last campaign. He accepted the principle of farm price supports. This prevented him from pointing out that farm price supports raise the cost of food for city workers. So he lost potential votes in the cities and even votes of the farmers themselves. For his belated and half-hearted acceptance of the “parity” nonsense made them suspect that he and the Republicans would offer them less of the taxpayer’s money than Mr. Truman. Can the Republicans hope to win if they endorse the principle of Federal minimum-wage laws but offer only 65 cents an hour instead of 75 or only 75 instead of \$1? Can they hope to win if they come out belatedly for building private housing at public expense but offer only 500,000 units instead of Mr. Truman’s 1,000,000? Why so little

of a wonderful thing? In the first half of his speech Mr. Dewey seems to be for social security without reservation. In the second half he expresses concern about “a system where everything man gets from cradle to grave is doled out to him by a ruling clique.” But he does not tell us on what principle he decides how much social security is very, very good and how much more makes it sinister and bad. He does not tell us how, once we embark upon compulsory social security, we can prevent politicians of all parties from outbidding each other till the system has become a crushing burden. Does Mr. Dewey know that in France the cost to the employer of social benefits in 1947 was placed at some 36 percent over and above the wages in the metal industries and some 47 percent in the electrical industries?

In the admirable second half of his speech Mr. Dewey points out that our free system produces more than all the rest of the world together of steel, automobiles, and telephones. He properly ridicules “a little nationalizing” as “like putting just one drop of strychnine in a glass of perfectly good milk.” But his speech as a whole, like the 1948 Republican platform that he praises, is a tissue of self-contradictions (see this column, *Newsweek*, July 5, 1948).

Mr. Dewey wants to eat his cake and have it too. He wants a planned economy and a free one. He wants to face both ways. He is trying both to accept and reject the New Deal. His program, in six words, is: “Me too—but not as much.” Such a program could only lead to a third disastrous defeat.

The choice before the world today is nothing less than the choice between private enterprise and collectivist planning, between capitalism and socialism, between economic freedom and totalitarian serfdom. We must make up our minds. There is no right amount of strychnine in the milk. ☼

## What Are We Trying to Do?

February 28, 1949

From the beginning the basic aims of the Marshall Plan have been vague and confused. If anyone pointed to the economic misconceptions behind it, he was told that its aims were primarily political. If he called attention to its political inadequacies, he was told that the plan was primarily economic. Trying to pin down its purposes has been like trying to nail a custard pie against a wall.

Politically the Marshall Plan was an irrelevant way of dealing with the problem that the proposed Atlantic pact would face up to directly. Unfortunately, just at the time when our military assurances to Western Europe,

as the President has insisted, should be strong and unmistakable, our leading senators wish to make them weak and ambiguous.

Probably the most influential economic argument for the Marshall Plan a year and a half ago was the plea that Europe was starving. A typical cartoon showed an emaciated woman in rags, labeled “Europe,” begging for a crust of bread while a pompous, overfed windbag, labeled “Congress,” callously debated the matter. While the picture of European starvation was overdrawn and its causes misconceived, the wheat-crop failure in France, for example, was real enough. But now that European crops are good, American crops the greatest in history, and world prices are plunging downward, Administration spokesmen run in all directions at once. They urge us to send more food to a Europe that needs it less, in order to keep up American farm prices. Or they demand “emergency” expansion of storage facilities—when stocks of grain are already at record levels—in order to enable American farmers to withhold still more food from a world that these officials themselves insist is short of food.

It is frequently declared that the purpose of the Marshall Plan is to “raise European living standards.” But it has never been made clear to what level they ought to be raised. Is it conceived to be America’s duty to restore each European country’s living standard to that country’s prewar standard? Why? And what of countries in which industrial-production indexes already exceed the prewar figure—for example, Great Britain, Ireland, the Netherlands, Norway, Sweden, and Denmark? Why must we continue to pour in free help?

Or suppose (what is in fact true) that there are wide prewar and present discrepancies between the average per capita incomes in different European countries. Should we try to equalize the averages and bring the poorer countries up to the richer—perhaps with help from the richer? The National Industrial Conference Board has made a valiant effort to determine the average per capita 1947 national incomes of the ERP beneficiaries. Some results: Greece, \$117; Austria, \$302; Netherlands, \$392; Norway, \$448; Belgium, \$608; France, \$661; Great Britain, \$723; Denmark, \$730; Sweden, \$848.

It is clear that if the primary purpose were to eliminate poverty and to equalize living standards, the distribution of ERP help would be vastly different from what it is. For example, with reciprocal-aid provisions of the ERP, France gets 27.4 percent of the total, Britain 20.5 percent, and Belgium less than 1 percent, though

the Belgium per capita income is already below that of France or Britain.

What the ERP has in fact been trying to do is to pay for each country's foreign-trade deficit. Yet the size of its foreign-trade deficit is unrelated to a country's living standard or total production. A table of comparison might astonish Congress. The truth is that each country's trade deficit is today brought about mainly by a coercive exchange control combined with a false currency value. But successive Administration witnesses urging a continuation of the Marshall Plan have either treated this cause as negligible or ignored it altogether.

As a nation we have been pouring billions of dollars into Europe and are planning to pour in still more billions, without seriously stopping to ask ourselves just what it is that we are trying to do. ❁

## The Case for Private Loans

March 7, 1949

Suppose our government were to halt all its foreign lending programs and turn them back once more to private investors. We can imagine the following conversation between a government official from Ruritania and an American investment banker.

RURITANIAN OFFICIAL: As your government has stopped its giveaway program, we are forced to come to you private bankers. But of course there just aren't enough private funds for world revival.

AMERICAN BANKER: Why not? Our government never gave you anything that it didn't first take from private funds in taxes. Sufficient private funds certainly exist.

RO: But your investors show no desire to put them into Europe.

AB: For excellent reasons. Putting aside the Russian menace, which isn't your fault, your governments have systematically destroyed confidence.

RO: What assurances would restore it?

AB: I've made up a list. In view of the past record of your government, I'm afraid it would now have to pledge itself: (1) Not to seize or nationalize the American investors' capital or the private firms in which it was invested. (2) Not to impose crushing taxation. (3) Against price fixing, wage-increase decrees, or profit controls that would imperil our investment. (4) To impartial enforcement of contracts. (5) Against barriers to the removal of our private funds. (6) To remove exchange controls. (7) To make your currency freely convertible at its free market value. (8) To halt internal

inflation by balancing your budget and stopping further expansion of money and credit.

RO: You needn't go on. Our government will never consent to such policy reversals.

AB: Very well. Then American investors will not be interested in risking their capital in your country.

RO: This is economic imperialism! You are trying to dictate to our government! You wish to infringe the sovereignty of Ruritania! We are determined to have socialism! You are interfering in our internal affairs.

AB: Listen, who came to whom for a loan? We're not forcing you to do anything. You can have all the socialism you want. Only you can't expect to find American investors eager to subsidize and prolong it at their expense.

RO: This is ideological prejudice.

AB: Private investors do have a prejudice in favor of government policies that seem likely to insure production, the safety of their principal, and a sufficient profit.

RO: Ah, that's it! Private profit! It's insistence on *that* that holds up world recovery.

AB: On the contrary, it is the constant search for profit that maximizes and balances production. Profit is, in fact, the best indicator we have of how much production has actually taken place. If a firm in Ruritania manufactures something at a loss, it means that the value of the labor and raw materials put into making the product is greater than the value of the product itself. That isn't production but sheer waste of labor and materials.

RO: Are you contending that repayable private loans help world recovery more than non-repayable government gifts?

AB: Precisely. Take another look at that list of reforms. You will find that they are not only necessary to attract *foreign* private capital to your country but to the revival of your *domestic* investment. They would probably encourage your own terrified capital to come out of hiding to such an extent as to make you soon independent of foreign capital altogether. Such assurances are essential.

RO: Why didn't your government officials insist on these assurances?

AB: It wasn't their money. Besides, it would have created dangerous friction between governments. But we private bankers can safely suggest them, because we are after all only middlemen telling you what conditions are necessary to make Ruritanian securities attractive to private American investors.

RO: I appreciate your friendly advice. Perhaps after all. ❁



## Rent Control vs. Housing

March 14, 1949

We are all set to prolong rent control for at least another fifteen months. At the end of that period we will no doubt prolong it again. For the Administration means to extend rent control “until the supply of housing has caught up with the demand.” But every student of elementary economics knows that supply and demand are meaningless terms except in relation to a price. It is precisely prices, in fact, that bring supply and demand to a balance. As long as construction, repair, and service costs remain around 1949 levels, while we try to hold rents at prewar levels, supply never can catch up with demand. It is rent control itself that keeps supply from catching up with demand. It perpetuates the very problem it pretends to solve.

With the general cost of living 71 percent above the 1935–39 level, with furniture 96 percent above, clothing 96 percent above, food 105 percent above, and estimates of construction costs ranging from 80 to 145 percent above, our legislators insist on holding rents down to only 20 percent above. With weekly factory wages 144 percent above the 1935–39 level, the average worker pays for rent a far smaller percentage of his income than he ever did before the war or before the imposition of rent control.

In this column of Jan. 10 I discussed the pamphlet by Bertrand de Jouvenel on the appalling consequences of rent control in France. The British situation differs only in degree. The London *Economist* of Jan. 8 points out that where it was once considered normal for an English family to spend 20 percent of its income in rent, the proportion under rent control has dropped to the neighborhood of 10 to 12 percent. This decline, comments that journal, “is strange to find in combination with a severe shortage of housing—unless, indeed [as may be much truer than most people imagine] the low relative level of rents is a large part of the cause of the housing shortage.”

I have been receiving recently a number of letters from worried property owners. One that comes from a widow in Evansville, Ind., is typical:

“The majority of landlords are not wealthy people. . . . But today a landlord is apparently a despised citizen, classed with gangsters and criminals, all because he happens to have a house, for which he has worked and saved, and which somebody else now wants to occupy at his expense—namely, the tenant. The law gives it to him, because there are more tenants than landlords and that means more votes. . . . Tighe E. Woods claims that if rents were decontrolled they would go up 55 percent.

Perhaps; perhaps not. Ten years ago I could get a room papered for \$6; now it would cost me \$20. What percentage of increase is that? . . . Naturally tenants want the law continued. If Congress were to pass a law to force grocers to give me groceries at half price I might endorse it myself. . . .”

If rent control is ever terminated, it will be because people come to recognize that under it old housing rapidly deteriorates and new housing finally ceases to be built. No new private apartments are put up in France today, for example, because they would have to rent at ten to thirteen times present rent ceilings in order to repay the costs of construction. Even in our own country there is already increasing pressure for solving the problem by public-housing schemes—that is, by forcing the taxpayers to subsidize each other as tenants.

To get us out of this government-created crisis I can only renew the type of compromise suggestions I made in this column of Feb. 2, 1948. Permit landlords now to raise rents each month, say, by 2 percent of the percentage that other items in the cost of living have increased since 1935–39. It would then still take 50 months, or more than four years, for the permitted increase in rents to equal the average rise in other items. At the end of that time decontrol could be automatic. Such a program would restore the incentive to maintain and build private rental housing at the same time as it got us tenants back to economic realities without too much of a jolt. ❁

## 4,000 Years of Price Control

March 21, 1949

Tablets, said to be 200 years older than the Babylonian Code of Hammurabi, have just been translated which show that the ancient kingdom of Eshnunna had wage control and price control. The news ought not to have come as a surprise. For the code of Hammurabi itself (unearthed in 1902), which was promulgated earlier than 2000 B.C., fixed prices, wages, interest rates, and fees. This makes price control at least about 4,000 years old.

The real economic discovery of civilization was the free market. It was Adam Smith, in *The Wealth of Nations*, published in 1776, who more clearly than any other mind up to his time glimpsed the marvels of the free market. In the first flush of his discovery he compared the system of free prices and free profits and losses to “an invisible hand” that led men pursuing their own interest to promote the welfare of the



whole nation more effectively than when they deliberately tried to promote it.

It was in 1776 also that Gibbon, in *The Decline and Fall of the Roman Empire*, wrote: "When the luxurious citizens of Antioch complained of the high price of poultry and fish . . . the emperor [Julian] ventured on a very dangerous and doubtful step, of fixing, by legal authority, the value of corn. He enacted that, in a time of scarcity, it should be sold at a price which had seldom been known in the most plentiful years. . . . The consequences might have been foreseen, and were soon felt . . . The proprietors of land or of corn withheld from the city the accustomed supply; and the small quantities that appeared in the market were secretly sold at an advanced and illegal price."

Sixty years prior to Julian's venture, Emperor Diocletian, in A.D. 301, had issued a famous edict fixing prices and wages. The punishment for exceeding the prices fixed was death or deportation. "The edict was well-intended but abortive," comments the *Encyclopedia Britannica*. "The actual effect was disastrous."

Let our history skip now to 1793, when the leaders of the French Revolution, in a desperate effort to offset the consequences of their own reckless overissue of paper money, passed a law imposing price ceilings. It was in some respects more reasonable than our own OPA. It allowed prices to be one-third higher than in 1790; it permitted the addition of a 5 percent profit for the wholesaler and 10 percent for the retailer. But as Andrew D. White wrote in 1876: "The first result of the *Maximum* [price law] was that every means was taken to evade the fixed price imposed, and the farmers brought in as little produce as they possibly could. This increased the scarcity, and the people of the large cities were put on an allowance. Tickets were issued authorizing the bearer to obtain at the official prices a certain amount of bread or sugar or soap or wood or coal to cover immediate necessities."

But even with this early rationing system the law "could not be enforced." Shopkeepers "could not sell such goods without ruin. The result was that very many went out of business and the remainder forced buyers to pay enormous charges under the very natural excuse that the seller risked his life in trading at all. That this excuse was valid is easily seen by the daily lists of those condemned to the guillotine, in which not infrequently figure the names of men charged with violating the *Maximum* [price] laws." Within a little more than a year the law had to be repealed.

The moral of our little history is familiar. It is that "those who cannot remember the past are condemned to repeat it." For this is what our "modern" governments

do today all over the world. Ironically, it is those who now wish to return to this ancient totalitarian device who are fondest of calling themselves "progressives." They are also fond of saying that those who believe in economic liberty "are living in the nineteenth century." These controlists have yet to learn that they themselves are still living, as the discoveries in Babylonia attest, in the nineteenth century—B.C.! ☸

## Sense Instead of Dollars

March 28, 1949

The Marshall Plan has now become sacrosanct and apparently impervious to argument or facts. Even when a high official of the British Government blurts out in an official speech that Britain has now achieved complete recovery, he raises only a few eyebrows in Congress, and these are promptly lowered by the hasty assurance of other officials that the first one spoke out of turn. Yet Undersecretary Mayhew's statement is confirmed by the official indexes of Great Britain, and for that matter of Ireland, the Netherlands, Norway, Sweden, and Denmark, which show that industrial production in all these countries is now above the prewar level.

When this is pointed out, the reply is: "True; but our country still has an unfavorable balance of trade; and of course it is the American taxpayer's duty to pay for it. And he may as well know that we intend to go on buying more than we sell even beyond 1952."

In brief, in spite of the fact that these countries are now producing more than they produced before the war, they announce that they will continue to live beyond their means. They will continue to consume more than they produce. They will continue to buy more than they expect to pay for. They present figures showing what their foreign-trade deficit is *going to be* in future years. They talk as if a foreign-trade deficit were something foreordained, some malign fate, instead of something that they bring about by their own policies.

It is not merely the former European belligerents but our Latin American neighbors, and in fact nearly all the former neutrals, who now complain of a "dollar shortage." The primary cause of these chronic foreign-trade deficits and dollar shortages is not mysterious. It is exchange control. Every government that imposes exchange control contends that it is forced to do so by the dollar shortage. The truth is the reverse. It is the exchange control itself that causes and perpetuates the dollar shortage.

It is needless to spell out here all over again just how and why it does this. I have explained the reasons in my

book *Will Dollars Save the World?* in 1947 and in numerous *Newsweek* columns since. They have been pointed out in the last few years by such economists as John Jewkes in England, Wilhelm Röpke in Switzerland, Trygve Hoff in Norway, and Gottfried Haberler and Walter Sulzbach here, to mention only a few. But so far as the ECA is concerned, they might just as well never have written.

Perhaps an analogy would help. The 1947 per capita income of Mississippi was lower than that of Great Britain, Denmark, Sweden, or France. Yet Washington did not start rushing millions of dollars into Mississippi either to “halt Communism” there or to enable Mississippians to buy more goods from New York. But if Mississippi’s state government suddenly decreed that 50 cents in Mississippi was worth \$1 in New York; if it ordered its exporters to turn over all their dollars from sales to New York to the state government and accept only 50 cents apiece for them; and if Mississippi’s government then allotted the proceeds to its importers to enable them to buy every dollar’s worth of goods from New York at a cost to the importer of only 50 cents—then everybody in Mississippi would want to import from New York and nobody in Mississippi would be crazy enough to export to New York. Mississippi would immediately have an unfavorable balance of trade and an appalling shortage of New York dollars.

If Congress is determined to go ahead with the ECA—as apparently it is—then it ought at least to insist on one minimum condition. This is the abolition of exchange control. Such a condition would not only save American taxpayers billions of dollars; it would do more than any other single measure to restore free enterprise in Europe and bring real world recovery. Exchange control is not only a totalitarian device in itself (inspired by Hitler’s *Schacht*); it is the keystone of present European controlism, nationalism, and socialism. ❁

## Military vs. Economic Aid

April 4, 1949

The purpose of the Atlantic Pact is twofold. It is to strengthen the democracies of Europe to maintain their integrity and independence. And it is to give the clearest possible warning to Stalin of the consequences of any threat on his part to that integrity and independence. The Atlantic Pact is not merely the strongest single measure to assure the world’s peace today; it is perhaps our only hope of peace.

The pact can achieve its purpose only if its pledges are unmistakable. For the clearer we make these pledges, the less likely we are ever to be called upon to meet them. The weaker and more ambiguous the pledges, the more liable we are to tempt the Kremlin to gamble on our indecision. In short, a weak and ambiguous commitment on our part would actually be more dangerous than a firm and unequivocal one.

The Senate, therefore, should not only ratify the pact promptly, so that the masters of Russia will not be tempted to exploit any interval of indecision, but whatever uncertainties are left by the language of the pact itself should be removed by the declarations of senators, by interpretations of the pact by the President and the State Department, and even (though this is constitutionally supererogatory) by a strong resolution of endorsement on the part of the House.

These political steps will clear the way for reconsideration of the economic phases of our foreign policy. The strange assumption has grown up in this country that the extent of our “international cooperation” is something to be measured primarily by the number of dollars we are willing to give away. It is taken for granted that our participation in the Atlantic Pact must necessarily cost us at least a couple of billions more on top of the \$5,580,000,000 already asked for continuance of the ERP. If it were really necessary for us to contribute a couple of billions to help rearm Europe, these funds could easily be taken out of this \$5,580,000,000 for “recovery.”

Not only is there no need for us to pay for European rearmament, however, but with our participation in the Atlantic Pact the last excuse for the continuance of the ERP in its present form has disappeared. The *economic* arguments for the ERP, as I have tried to point out in previous articles (e.g., *Newsweek*, Feb. 28) are hopelessly confused. Now the *political raison d’être* of the Marshall Plan has disappeared. For politically the Atlantic Pact does directly what the Marshall Plan did only symbolically.

The European democracies have in fact the resources to rearm themselves. And if they lack determination to do this, any monetary contribution we make to their rearmament will be worse than futile. For there is no way in which we can insure that either the money or the equipment we contribute will actually result in a net increase of European armament by that amount.

It will do no good, in other words, to earmark our contributions to make sure that they are used for rearmament. Suppose, for example, that Ruritania decides that it is essential to provide  $x$  millions of dollars for

defense. It will spend this amount by taking it out of other potential expenditures, whether we make any contribution or not. But if American instead of Ruritania taxpayers contribute this  $x$  million dollars, there is no assurance that Ruritania will spend our  $x$  million dollars in addition to the amount of money it would have spent for defense anyway.

It is far more probable that our contribution would simply release Ruritania resources for spending in other directions. Ruritania, freed from necessity for military spending, has just that much more available for bigger social security schemes, bigger food subsidies, bigger nationalization deficits, or whatnot.

This simple economic principle of substitution has been ignored in all the proposals for American rearmament of Europe as well as in the "special accounts" and similar futile efforts of the ECA to check the use in Europe of our specific ERP dollars. ☸

## Whose Bold New Program?

April 11, 1949

In his inaugural address President Truman announced what has now become the famous "fourth point"—"a bold new program" for "underdeveloped areas," a program to "foster capital investment in areas needing development," to "greatly increase the industrial activity in other nations," and to "raise substantially their standards of living."

No sooner was this announced than the brains of Washington bureaucrats began to bubble with grandiose schemes for giving away still more of the American taxpayer's money to foreign lands. Our government representative put the idea before the Economic and Social Council of the United Nations, which adopted a resolution approving it. Now the ECA has set up a "colonial development division." And Deputy Administrator Bruce says that this new division is intended to carry out "point four."

Before we go farther with this idea it may be instructive to look into its origin. I do not know who sold the idea to Mr. Truman. But at least the record shows clearly where the idea came from in the first place. The following quotations are from a book published in 1944:

"America can underwrite a gigantic program of the industrialization of Africa, to be launched immediately. . . . It must initiate a general and steady rise in the standard of life of the African peoples. . . .

"Closely related socially, economically, and politically with Africa are the Near Eastern countries of Arabia, Iraq, Iran, Syria, Lebanon, Palestine, and Trans-Jordan. . . . Here also a broad regional program of economic development is called for. . . .

"What is clearly demanded by the situation is that the United States take the lead in proposing a common program of economic development of the Latin American countries. . . . For Latin America [such a program] opens the door for an immense leap ahead in progress. . . .

"For the United States especially it contributes a large part of the answer to that all-important question as to whether we shall be able to keep our national economy in operation. . . .

"The government can do it, if 'free enterprise' fails to meet the challenge and bogs down on the job.

"Our government can create a series of giant industrial development corporations, each in partnership with some other government or group of governments, and set them to work upon large-scale plans of railroad and highway building, agricultural and industrial development, and all-round modernization in all the devastated and undeveloped areas of the world. America has the skilled technicians capable of producing the plans for such projects, sufficient to get them under way, within a six-month period of time after a decision is made. . . .

"On a world scale the combined projects could be self-liquidating in the period of a generation. They would become the best investments the American capitalist class had ever made in its whole history."

The book in which this proposal appeared five years ago was *Teheran: Our Path in War and Peace* (International Publishers). And the name of the author was Earl Browder, then still officially head of the American branch of the Communist Party (temporarily calling itself the Communist Political Association).

We need not point out here everything that is wrong with this proposal on political and economic grounds. We need not point out, for example, that every million dollars of capital we send abroad sets back our own capital development by just that much. And this at a time when President Truman himself insists that "at least \$50,000,000,000 should be invested by industry to improve and expand our [own] productive facilities over the next few years," and when he complains that our own steel, oil, and electrical industries are not being expanded fast enough to suit him.

It is enough to point out for the moment that the idea for the "bold new program" comes straight out of the book of the then head of the Communist Party in this country. ☸



## Bankruptcy of the Welfare State

April 18, 1949

The harsh realities of the new British budget were anticipated by the London *Economist*. As that weekly pointed out in its issue of March 19:

“The price of government in Great Britain today is 40 percent of the total of all incomes. . . . This is the hideous prospect that faces the British people. Even though every item of government expenditure is approved in detail . . . any such rate of taxation, if continued for long, will be disastrous to the national economy. . . . A state that taxes away 40 percent of all incomes, and much more of the incomes of the successful and the energetic, is killing the motive power that keeps it alive. . . .

“If taxation remains at 40 percent, it will be impossible for the community to generate enough savings to maintain its capital. . . . The long continuance of taxation of anything like 40 percent of the national income will ruin the country. It will not do so spectacularly in any one year or the next—there might be more hope if it would. . . .

“The lamentable thing is that it is very difficult, to the point of impossibility, to see how we can escape from the vise in which we are caught. . . . It is still official policy that the food subsidies—or most of them—are temporary, but it requires a sanguine temperament to believe that any government will ever dare actually to take them off. . . . There will have to be outright repeal of one or more major social schemes. Which is it to be? Education? The health service? Unemployment insurance? Old-age pensions? Housing subsidies? The whole face of British politics would have to suffer a complete change before any one of these became possible. It is a lamentable truth, but an inescapable one, that the British democracy would rather ruin itself than give up any one of its major spending projects. . . . Unless the price of government is reduced, the British economy will gradually strangle itself.”

All of which was confirmed by Sir Stafford Cripps in his budget speech. “How then are we going to get along with all this load of expense on our backs? By producing more.” But he neglected to point out that the tax load itself erodes the incentives and capital that increase production.

The amount of our own national income being taken by our Federal and local governments is about 25 percent. Some may think this moderate compared with the more clearly ruinous British 40 percent; but it is in fact dangerously excessive. The British, at least, still have part of their capital deficiency made up for them by our ERP. There will be no one to do that for us.

Yet not a day passes without a new government spending scheme being put forward in Washington, or in the states and cities. President Truman will soon propose a new multi-billion-dollar national health program. We are being asked to throw still more billions into Europe for armament. Our Secretary of Agriculture wants a new and more extensive type of multibillion-dollar farm subsidy. The public housing advocates are vociferous. The education lobby demands \$10,000,000,000 in the next ten years for new school buildings.

All of these people talk as if the funds they were demanding were created by the government out of thin air, or could be taken out of some mysterious but inexhaustible idle reserve somewhere. They haven’t yet learned arithmetic. They still refuse to recognize that every dollar appropriated for them or their schemes leaves just one less dollar to the family who has earned it to spend for its own food or housing or clothing, or save for education or travel.

Our government spending zealots have not yet learned that the American tax burden is already excessive. The additional funds they think can most easily be seized for taxes are precisely the most basic and most vital funds of all. They are the funds that would otherwise go into investment—into improving and increasing the tools and equipment in the hands of the workers, increasing their individual productivity, their real wages, and the national production on which all social progress depends. ❁

## The Welfare State Runs Wild

April 25, 1949

Secretary Charles F. Brannan’s new farm subsidy scheme at least admits what the Administration has hitherto denied—that the present farm price support program raises the cost of food to consumers. Inadvertently it also betrays the completely one-sided operation of the present program. The present “parity” was based on the contention that the 1909–14 relationship of farm to nonfarm prices (one of the most favorable to farm prices in our entire history) was the “normal” and “fair” one. But last year, Mr. Brannan concedes, “farmers received 160 percent of the theoretical parity income.” This is only another way of saying that industrial income or prices last year were 37½ percent below “parity.” But no farm lobbyist demanded relief for industry or even urged farmers to turn back subsidies to the government. Farm “relief” marched on.

Secretary Brannan now wants to change the system not because it pays farmers too much but because he



thinks it doesn't begin to pay them enough. He is worried about the "historical gap" between farm and non-farm income. Even last year "the average net income of farm people from all sources was only \$909 per capita . . . compared with the non-farm average of \$1,569." This difference is "indefensible." Farmers must have the same "standards of living afforded persons in other gainful occupation."

Now if farmers must be supplied with cash from the Treasury to bring their standards of living up to those in other gainful occupations, then in consistency why shouldn't those in every occupation be paid enough to have the same standard of living as those in every other? Why not cash subsidies to close the gap between average wages in work-shirt factories of \$26 a week and average wages in oil refineries of \$77 a week? Or to close the gap between the farmer with the lowest income and the farmer with the highest? Or to close the gap between the \$15,000 salaries of Cabinet officials and the \$1,400 average per capita income? Why not, in consistency, demand equality of everybody's income with everybody else's, regardless of his contribution to production?

Brannan outbids all previous subsidizers. He would let supply and demand determine the market prices of farm products, and then he would pay the farmers, in cash, the difference between these market prices and a "fair," or Brannan, price. For example: "If it is necessary to get milk down to the area of 15 cents a quart at retail, in order to have maximum consumption, and use production payments to assure farmers of fair returns, I think both farmers and consumers will want to do it." But why not reduce the price to 10 cents a quart? Or give it away free?

Apparently no proposal is now too preposterous or too insulting to the electorate's intelligence for the Administration to put forward. Brannan proposes high prices for producers and low prices for consumers. And his presentation never once mentions the Forgotten Man, the taxpayer, who is expected to pay the difference.

Brannan blandly talks as if the Treasury cash turned over to the farmer would be a net addition to the purchasing power for industrial goods. A schoolboy could tell him that it would be a mere transfer. The taxpayer would be deprived of exactly as much purchasing power as the farmer gained. But Brannan apparently relies on everyone's keeping the delusion that the taxpayer will turn out to be some other fellow. Naturally he did not give any estimate of the cost of his program. It is in fact impossible to estimate the cost without knowing in advance exactly what future conditions are going to be.

Brannan's scheme is a glaring illustration of what happens once we reject free markets, destroy the connection between income received and value produced, and accept the premises of the pressure-group welfare state. ❁

## Legally Certified Monopolists

May 2, 1949

The Taft-Hartley Act is essentially nothing more than an amended Wagner Act. Like that act, it in effect turns the government itself into a union-organizing agency. It is no accident that under the Taft-Hartley Act union membership has been at peak levels and that wage rates have gone up faster either than living costs or man-hour productivity.

Like the Wagner Act, the Taft-Hartley Act abridges management's freedom to manage. It compels the employer to "bargain collectively" with a particular union leader, no matter how unreasonable his demands may be. This requirement to "bargain" has never been precisely defined. In spite of specific limiting clauses introduced by the Taft-Hartley Act, and specific denials by the Labor Board, this phrase has been in practice interpreted to mean the making of concessions. For if the employer, in response to union demands, simply says "No," or simply proposes, say, in response to a demand for a wage increase of 15 percent, a wage reduction of 15 percent, and then sits tight, how can he be said to be bargaining "in good faith"?

More importantly, if he cannot reach an agreement with the particular leader of the union certified by the NLRB, there is no one else with whom he is legally permitted to reach an agreement. What would we expect the result to be if a manufacturer were legally permitted to bargain with only one supplier of a raw material, and were legally forbidden to negotiate with any other supplier if he could not reach a workable agreement with that one?

It is this exclusive bargaining provision, common to the Wagner and the Taft-Hartley Acts, and to the Administration and Wood bills, that has built up the tremendous economic and political power of the Lewises and Murrys, the Greens and Petrillos. These men have been turned into huge legally certified monopolists. They have been made, in effect, legal arms of the Government in their negotiations with management.

Instead of reexamining the dubious economic and legal principle behind this provision, the authors of the Taft-Hartley Act retained it, and then tried to limit and offset its most obviously harmful effects. The Wagner Act enormously increased the power and use of the strike weapon. For it took most of the risks out of strikes and deprived the employer of most of his previous economic power to combat strikes. The authors of the Taft-Hartley Act sought to offset this by putting in the hands of the government some of the anti-strike powers that had been stricken from the hands of the employer. And they sought to “balance” some of the coercions on the employer by corresponding coercions on the unions. For example, they made it “an unfair labor practice” for a union as well as an employer “to refuse to bargain collectively.”

But the moment an effort was made to put any limits whatever on the power of union officials, these officials, who had not only acquiesced in but demanded the one-sided government coercions on employers, denounced the two-sided provisions as a “slave labor” law. Therefore the present servile Administration bill, while continuing to impose upon employers a compulsory duty to bargain collectively with unions, would once more exempt unions from any corresponding obligation. “In short,” as the House minority report correctly sums it up, the Administration bill “would have the effect of encouraging, fostering, and nurturing uncontrolled union monopolies in the U.S., and of conferring upon union officials unbridled and unconfined monopolistic power.”

But that the Administration bill is so much worse than the Taft-Hartley Act does not mean that even the latter is good. By retaining the Wagner Act basic principles, it has in fact encouraged and made it possible for unions to impose excessive wage and other demands. These have already led to unemployment in some lines and threaten to bring it in others. There is little prospect that pending legislation will change this situation. ❁

## Salvation through Squandering?

May 9, 1949

We are now being told that our prosperity has been kept going in the last few years by our huge government spending, particularly on armaments and foreign aid. Any decline in this spending, we are now warned, would bring a recession. We are told, in fact, that if

further signs of recession develop the Government must spend still more to keep the boom whipped up.

This doctrine is completely false. Assuming a balanced budget, an increase in government spending does not on net balance stimulate business activity at all. For every dollar that the government spends, the tax-payers have been deprived of a dollar to spend. All that a heavy government spending program can do is to *divert* spending from one channel into another. If we give Europeans more money to buy American goods, we have just that much less money left to buy our own goods. If we spend more for armament, we have just that much less left for television sets, refrigerators, or food. Even the Nazis knew they were choosing between guns and butter.

A huge government spending program with a balanced budget not only fails to stimulate economic activity but greatly reduces economic welfare. A \$15,300,000,000 armament program, regardless of its military justification, leaves us just that much less resources to build new housing or to increase or improve our tools of production for civilian goods. Whether or not our new \$5,000,000,000 ERP donation is now needed in Europe, it must obviously force us either to reduce our own consumption or to retard our own capital development by that amount. We cannot give our cake away and eat it too.

The more sophisticated advocates of a “compensated economy” recognize that huge government expenditures do not in themselves create prosperity. They put their emphasis on the amount of monetary purchasing power that government spending *adds*. This, they point out, is determined by the *excess* of government expenditures over tax collections. Put more bluntly, the prosperity would be brought about by government *deficits*. It is not the total size of the government expenditures but the size of the deficits that “adds to purchasing power.”

But when the compensated-economy doctrine is clearly stated in this form it has implications that its proponents have never clearly recognized. The official estimate of government receipts for the 1950 fiscal year is \$41,000,000,000. Suppose it were decided that what was necessary to keep the boom whirling was a deficit of \$5,000,000,000. This could, of course, be achieved by spending \$46,000,000,000 (Mr. Truman has already put forward more than enough schemes to do that easily). But the inflationary deficit could be achieved just as well by holding expenditures to \$41,000,000,000 and *reducing taxes* to \$36,000,000,000. Or even by *reducing expenditures* to \$36,000,000,000 and reducing taxes to \$31,000,000,000. We could cut expenditures

indefinitely, in other words, and still get our added inflation, provided only that we cut taxes still more.

Moreover, taxes could be either reduced or restored quicker than expenditures could be increased or halted. Increased expenditures create determined vested interests and tend to become permanent. Higher taxes to support higher spending destroy incentives and production. Lower taxes increase incentives and production. In short, if we wish to embark upon deficit financing again to keep our inflationary boom going, doing it through tax reductions is more flexible, more effective, and less dangerous than doing it through higher government spending.

But all this merely emphasizes the bankruptcy of the whole compensated-economy doctrine. Increased government expenditures balanced by increased taxes do not keep a boom going at all. Only deficits, financed by the creation of more money and bank credit, could do that. But this would mean merely a resumption of monetary inflation. It could prolong the boom only at the eventual cost of a bigger bust. ❀

## The Right to Strike

May 16, 1949

The right to strike is commonly defended as if it were identical with the right of the individual to quit work. To limit the right to strike, it is therefore asserted, is to impose economic "slavery."

But just as there are qualifications (as reflected in our libel and obscenity laws) even to the right of free speech, so there are qualifications even to the right to quit work individually. A surgeon who quit in the middle of an operation, a railroad engineer who left his train and passengers at a deserted place, or a ship captain who left a sinking ship before the passengers or crew, would be held guilty of criminal neglect of duty.

Moreover, the attempt to treat the right to strike as identical with the right of the individual to give up his job must be set down as either confused or hypocritical. It is not merely that in a strike the workers quit simultaneously and collusively. The difference goes much deeper. For the strikers are not in fact giving up their jobs. On the contrary, they want to keep those very jobs—on better terms. They insist, in fact, that they have property rights in these jobs. They often resort to intimidation, coercion, and violence in order to prevent others from taking the jobs that they themselves have voluntarily abandoned.

So when most union leaders insist on the unbridled right to strike, they are insisting not merely on the right of union members to quit work but on their right to prevent others from taking the jobs they have vacated. They assert the right to prevent others from working. It is a merit of the Taft-Hartley Act that it at least partly and indirectly takes cognizance of this. It makes it (section 8b) "an unfair labor practice for a labor organization or its agents to restrain or coerce employees in the exercise of the rights guaranteed in section 7."

In the case of the Smith Cabinet Manufacturing Co. the Labor Board found, for example, that the following conduct of the United Furniture Workers of America, Local 309, CIO, constituted such restraint and coercion: "(1) the carrying of sticks by the pickets on the picket line; (2) the open piling of bricks for use by the pickets; (3) the blocking of plant entrance by railroad ties, automobiles, raised gutter plates, and tacks; (4) the threat of violence to the nonstriking employees over the loudspeaker . . . (7) the warning given nonstriking employees that 'when we get in with the union you old fellows won't have a job'; (8) the placing of pickets in such a manner as to prevent nonstriking employees from performing their work; (9) the goon-squad mass assaults upon various nonstriking employees . . . (12) the barring from the plant of Superintendent Simpson and Foreman McKinney by force and intimidation . . ." And so on.

Mr. Truman would have been on strong ground, economically and legally, if he had asked simply for the repeal of the Taft-Hartley Act, period. But he tried to force a return, with the Lesinski bill, to the intolerable conditions under the one-sided Wagner Act in which the Labor Board was not authorized to take cognizance of the kind of outrages just outlined, though it compelled the employer to recognize and "bargain" with unions that practiced such outrages.

If a Federal labor relations act, therefore, is to be retained, not only must it keep the substance of Taft-Hartley section 8b but one of the most important additions would be an explicit declaration that mass picketing is *prima facie* evidence of intimidation and that any union resorting to it would forfeit the privilege of using the facilities of the Labor Board.

Such a provision would be far sounder than all the present dubious efforts to legalize strikes as such. We must never lose sight of the vital difference between the real right to quit work peaceably and the spurious right forcibly to prevent others from working. From time immemorial most union leaders have tried to tie



the two together in the same package, and to practice the second in the name of the first.

But the right to work is as sacred as the right to quit work, and no less in need of protection. ❁

## Our Irresponsible Budget

May 23, 1949

In a series of five articles in *Newsweek* running from Jan. 10 through Feb. 7 Raymond Moley called attention to the “colossal failure” of our Presidential budget system. In line with the recommendations of the Hoover report, he suggested reforms of the Bureau of the Budget and the General Accounting Office to make these the real watchdogs they were originally intended to be when they were set up in 1921.

The budget reforms suggested by Moley seem to me to represent a minimum program. Even if they were adopted I fear that we would still be far from a really responsible budget. These reforms would help the President to watch and control the spending of his executive agencies. They would help Congress to watch and control the spending of the President. But who would watch and control the spending of Congress? And who would prevent the President, the House, and the Senate from trying to outbid each other in a three-sided competition to reach into the Treasury to spend the people’s money to curry favor with special group interests?

This problem has been with us since the birth of the nation. But it has now acquired unparalleled dimensions and gravity. For three years Congress has failed so ignominiously to abide by the self-imposed legislative budget requirements of its own Reorganization Act of 1946 that it is preparing to abandon them. And with shocking irresponsibility the House seems to be about to vote still another handout to veterans that would cost \$9,000,000,000 at a “rough estimate.” This would be casually thrown on top of the most staggering peacetime expenditures ever made by this or any other government in the history of the world.

There can be no fiscal responsibility at Washington as long as Congress exercises the power to make appropriations not even asked for by the President. The British Parliament can make no expenditure that “the government” does not request. One result of this wholesome rule is that the Chancellor of the Exchequer is forced to present a responsible budget. When it accepts that budget, Parliament in effect authorizes all the proposed expenditures and proposed taxes at a single stroke. It is shown the budgetary situation as a whole. It acts simultaneously on both sides of it. Our own Federal “budget,”

by comparison, is a meaningless bit of window dressing. Congress neither accepts nor rejects it. It plays by ear, making its real decisions on numberless individual and unrelated appropriation bills as it goes along. Appropriations and taxes are left to different committees not responsible to each other.

This chaos will never really be cured until the House and Senate themselves ask for a self-denying constitutional amendment under which, say, the House could not make any appropriation not requested by the President and the Senate could not increase any appropriation above that made by the House. Only this could end our three-sided spending competition. The House would still be free to cut the expenditures proposed by the President. The Senate would still be free to reduce the appropriations of the House. Unable to raise, they would at last exercise their power to reduce. As Henry Jones Ford pointed out: “There is no propensity of human nature more marked than jealousy of opportunities that one does not share.”

Historically, “the power of the purse” in the hands of the people’s representatives meant the power to *withhold* the purse from the sovereign executive. The House and Senate can never be expected properly to exercise the vital function of guardians of the public Treasury as long as they themselves are allowed to put their hands in the Treasury.

It may seem unrealistic to assume that either the House or Senate would ever approve such a self-denying amendment. Many may therefore dismiss this proposal as either academic or impossible. But until such a reform is made, we will continue to pay the enormous and perhaps finally unbearable costs of a budget out of control. ❁

## Arms and the Money

May 30, 1949

The commitment we have made to defend the integrity of Western Europe has been forced upon us by the Russian threat. It is a grave and tremendous commitment. In return for it, our negotiators had both the right and duty to ask heavy quid pro quos. Instead, they assumed that they had to promise monetary and military aid *in addition* in order to bribe Western European governments to accept the tremendous pledge from us for which they have been begging ever since 1914!

If Western Europe has a will to defend itself, it will have little trouble in finding the means. The \$1,130,000,000 grant that we have promised them for the first year is after all only 3 percent of the present



total governmental expenditures of the Atlantic Pact nations. They can easily make that up by cutting less essential things out of their swollen governmental budgets.

On the other hand, as I pointed out in a *Newsweek* article of April 4, there is no way in which we can insure that either the money or the equipment we contribute would actually result in a net increase of European armament by that amount. To the extent that we free European governments from the necessity for military spending, we release just that much more of their resources for bigger social-security schemes, bigger food subsidies, bigger nationalization deficits, or whatnot.

It is now being argued that we can solve this dilemma by insisting that each beneficiary European government spend on armaments in the next fiscal year, say, at least as much as we contribute, in addition to the amount it has already been spending in the current fiscal year. But it is dubious policy to try to force any country to spend more on defense than it thinks it ought to spend. This could easily give rise to the unwholesome belief in that country that it was spending large sums on defense, not for its own self-preservation but as a favor to us. It might also tend to encourage book-keeping fictions under which government expenditures were charged to the military budget that did not in fact belong under that budget.

If our Administration is nonetheless determined to go ahead with its \$1,130,000,000 military-aid program, then Congress, instead of adding this to the already dangerous burden upon our taxpayers, should take it out either of our proposed military budget of \$15,300,000,000 or of the \$5,430,000,000 authorized for the ERP.

Consider the military budget first. For a single year it already equals the military expenditures for the entire *nineteen* years from 1922 through 1940. Must our military budget now be larger still? Does it make any sense to assume that our military expenditures *with* the Atlantic Pact must be actually higher than *without* the Atlantic Pact? Even if we do not assume that the Atlantic Pact in effect adds the existing military expenditures of Western Europe to our own, can we not assume that if we transfer a billion dollars of our defense expenditures to Europe, it at least removes the necessity of spending that billion dollars here?

Finally, if the Administration refuses to take this \$1,130,000,000 out of the home military budget, Congress could take the whole amount out of the \$5,430,000,000 authorized for the ERP. It could simply authorize the beneficiary European governments to use up to this amount of their ERP funds for buying

armament from us instead of other things. As it is, we are about to throw most of this \$5,430,000,000 away anyhow.

We are turning it over to European governments to meet a trade deficit that they themselves have brought about by exchange control with overvalued currencies. Our ERP funds, in short, are being used in the main to subsidize and prolong a vicious totalitarian device that strait-jackets economies, retards recovery, and makes impossible the free multilateral flow of world trade.

The further burden on our budget involved in the proposed European armament-aid program is without logic or excuse. ❁

## World Statism in Wheat

June 6, 1948

The International Wheat Agreement, now before the Senate, is briefly described by Secretary Brannan as "a multilateral four-year contract in which each of the five exporting nations [principally Canada, the United States, and Australia] agrees to sell a stated quantity of wheat at \$1.80 a bushel if requested to do so by the importing countries. . . . Each of the 36 importing countries, in turn, agrees to buy a stated quantity of wheat at the floor price if requested to do so by the exporting countries. The floor begins at \$1.50 and drops 10 cents a year to \$1.20 the fourth year."

The purposes of the agreement, in its own words, are "to assure supplies of wheat to importing countries and markets for wheat to exporting countries at equitable and stable prices."

Now if world market prices throughout the four-year period never dropped below the floor or rose above the ceiling prices, then the agreement would do no harm. But in that case it would also be quite unnecessary. If the market price of wheat during the four years, however, falls below the agreement's floor price, the taxpayers of the importing countries will be forced to take an unnecessary loss. If, on the other hand, the world market price of wheat rises substantially above \$1.80 a bushel, the farmers or taxpayers of the exporting countries must take an unnecessary loss. Both sides can't win. Either the exporting or the importing nations are deceiving themselves about the benefits of this agreement. Either the exporting or the importing nations will later regret their bargain, and some of them may try to wiggle through the escape clauses.

The specious argument that the agreement will "stabilize" wheat is precisely the same argument that was put forward in favor of the ill-fated Japanese silk

and British rubber restrictions and our own cotton schemes. What the bureaucrats always overlook is that a forced stability in prices brings instability in production and discrepancies between supply and demand. It is precisely free markets and free prices that signal the existence and relative gravity of shortages and surpluses and that bring continuous self-adjustment. Abnormally high prices stimulate more production and bring economies in consumption. Abnormally low prices encourage more consumption and discourage the production of surpluses.

In this way the relative production of thousands of commodities and services is synchronized and balanced. When this free movement of prices is prevented or bypassed by government action, productive adjustments are also prevented or postponed. They must be all the more violent when they are finally and inevitably made.

To sell the wheat agreement here, a great bribe has been held out to our farmers. Listen to Secretary Brannan: "In years of ample supply the price of wheat to the U.S. farmer will largely be governed by domestic price-support policies. In years of short supply, nothing in the agreement will operate to impede the free movement of domestic prices above the price-support level." So domestically the farmer wins both ways, heads or tails, either at the expense of the taxpayer or at the expense of the consumer.

But the wheat agreement, in addition, "will require a subsidy whenever U.S. prices for wheat are over the maximum prices." So it doesn't concern the farmer at all if the maximum agreement price of \$1.80 turns out to be below the market. It is the American taxpayer who will be required to dig in his pocket for the difference.

The International Wheat Agreement represents just one more typical mesh in the net of spurious "internationalism" that is being woven by the bureaucrats of the world around their own nationals. What they offer is not the real internationalism of free trade and free markets. It is something ominously different. It is international controls, international statism, government-to-government bulk sales, state buying and selling—in brief, a flattering imitation of the very economic devices of the Iron Curtain countries that they profess to deplore. ☼

## What Are We Paying For?

June 13, 1949

Suppose a relative who keeps a pleasure car comes to you and tells you that he hasn't enough money to feed his family. You suggest that he sell the car. He replies

that the car is essential for his morale and to keep his family from going communistic. He adds that it is not for you to interfere in his private affairs or tell him what his family can have or not have. He assures you, however, that the particular dollars you contribute will go only for his family's food.

Such an assurance will satisfy you only if you are an idiot. In that case you will merely insist that he deposit all the money you give him in a special bank account, that the checks he draws against this shall be only for his family's food, and that he send you a regular accounting to prove this.

But if you have a grain of common sense left, you will know that all this is meaningless make-believe. You will know that you are in fact paying for his pleasure car and his other extravagances. You will know that when you pay for his family's food, he doesn't have to use his own income for this and can therefore spend it on luxuries. You will know that it is pointless to make him keep this segregated account, that you are in fact adding to his total spending income, and that what his family spends on luxuries is in effect the money you have contributed.

But if you are an official of the ECA or of the State Department, in charge of giving away other people's money, you won't know any of these things. You will solemnly set up special earmarked accounts, checks, "counterpart funds," and other such pointless paraphernalia. And if anyone points to the appalling deficits in nationalized industries that are being paid for by the socialistic governments that you are helping to support, you will bring out your little account books to prove that it isn't our funds that they are spending for this, because our funds are used only to buy food or machinery or other austere necessary things.

I have already pointed out several times in this column that there is no way in which we can insure that either the money or the equipment we contribute under an arms aid program would actually result in a net increase of European armament by that amount. For to the extent that we free European governments from the necessity for military spending, we release just that much more of their own resources for such things as bigger social-security schemes or bigger nationalization deficits.

Now this principle of substitution also works the other way round. Our officials forget that we are *already* helping to rearm Europe with our ERP funds. For to the extent that we have supplied European governments with other things, we have freed just that amount of their own money and resources for armament.

The Administration argues that the \$5,000,000,000 or so it is asking for the next year under the ERP will go exclusively for “recovery” and the \$1,130,000,000 exclusively for military aid. It thinks so because it will earmark each fund for this specific purpose. The real effect would be that instead of contributing roughly \$5,000,000,000 in the next year to European government expenditures of all kinds, we would contribute \$6,130,000,000 toward those expenditures. For as long as European governments control their own spending, the funds we contribute go in fact, if not in form, into a common spending pool.

But whenever Congress, vaguely sensing this, tries to make even the most timid economies, the ECA officials rush in to say that the whole European “recovery” program is being imperiled, that the amounts have been carefully figured, and that you can’t rescue a boy from a 15-foot well by throwing him only a 10-foot rope. As the amounts asked for are in fact completely arbitrary, as they are in fact calculated on the basis of a trade deficit that is itself being brought about by exchange control, overvalued currencies, and other wholly unsound European policies, this facile analogy is without substance. ❁

## The Ideological War

June 20, 1949

In a recent speech General Clay warned the American people that the struggle between collectivism and democracy would continue “for years to come.” We can hope to win this struggle between collectivism and individualism, between socialism (and/or Communism) and capitalism, between totalitarianism and freedom, only if we frankly recognize its existence. The struggle will go on, in fact, until one system succumbs.

Our own befuddled “liberals” and wishful thinkers are loath to believe this. They are fond of saying that there is no reason why Communism and capitalism cannot live peaceably together in the same world. This is because they know nothing of the real nature of Communism and Communists. The Communists are committed to a war on capitalism until they have totally destroyed it everywhere.

This is the reason for the cold war that the masters of Russia have been relentlessly waging against us. And, with minor setbacks, they have been winning that war in the last five or six years because they knew it was being fought and we did not. That is why our leaders threw away at Yalta and Teheran and Potsdam the fruits

of a military victory won at unparalleled cost of blood and treasure. That is why, through inaction, confusion, or actual cooperation, our leaders helped Stalin to dominate, subdue, and communize Poland, the Baltics, the Balkans, Czechoslovakia, and China and didn’t even secure for themselves a tenable foothold in Berlin.

What we still do not recognize is that even if the cold war should break out into a shooting war our main weapon, if we hoped not only to win but to have our victory mean anything for the happiness and peace of mankind, would not be the atom bomb but ideas. This ideological war would cost incomparably less in dollars than any military war. But it would have to be above all informed and intelligent. Who would fight it? Who knows how to fight it? Certainly not the present Administration. Whether Mr. Truman realizes it or not, he is today fighting at every turn, not for free enterprise, but for controlism, for statism, for socialism, for policies that must undermine, sabotage, and in the end destroy free enterprise. We can pay money for a Voice of America program. But can we get it to say the right things? Our officials pay lip service to free enterprise. But when they become specific, they praise above all such things as our social-security program, our farm subsidies, our housing subsidies, our TVA’s. All these are collectivist. Incidentally they are all dependent on free enterprise. They are supported by the taxes drawn from the profits and incomes created by free enterprise. They are all, in short, parasitic on free enterprise. But it is these parasitic devices that our officials praise, while they ignore or apologize for the private enterprise that supports them.

It is not surprising that the Russians are not converted to capitalism when our own propagandists praise the collectivist elements in our economy rather than the free-enterprise elements. The astounding idea has arisen in the Western world that the way to fight Communism is to embrace socialism—that is to say, to move at least halfway to Communism.

The Communists themselves have a clearer view. William Z. Foster, in recently laying down the latest line for the American Communist Party, declared: “What will its [American capitalism’s] power of resistance to socialism be when, as may be likely, the vast bulk of the rest of the world has ‘gone socialist’? . . . It may well turn out that it will be far easier for the American working class, in the midst of an overwhelmingly socialist world, to establish socialism in this country than now appears to be the case.”

In short, we cannot win the ideological war for free enterprise unless we have a genuine faith in free enterprise, unless we have a real understanding of how it



works, and of why Marxist socialism and Communism are fallacious. To grope bewilderedly for a “middle road”—which is to assume that Communism must be at least half right—is to take the certain path to defeat and surrender. ❁

## Private Enterprise Regained

June 27, 1949

I am indebted to Betty Knowles Hunt for sending me a column she contributed to *The New Hampshire Morning Union* quoting from Governor Bradford’s own history of the Plymouth Bay Colony over which he presided. It is a story that deserves to be far better known, particularly in an age that has acquired a mania for socialism and Communism, regards them as peculiarly “progressive” and entirely new, and is sure that they represent “the wave of the future.”

Most of us have forgotten that when the Pilgrim Fathers landed on the shores of Massachusetts they established a Communist system. Out of their common product and storehouse they set up a system of rationing, though it came to “but a quarter of a pound of bread a day to each person.” Even when harvest came, “it arose to but a little.” A vicious circle seemed to set in. The people complained that they were too weak from want of food to tend the crops as they should. Deeply religious though they were, they took to stealing from each other, “So as it well appeared,” writes Governor Bradford, “that famine must still insue the next year allso, if not some way prevented.”

So the colonists, he continues, “begane to thinke how they might raise as much corne as they could, and obtaine a beter crope than they had done, that they might not still thus languish in miserie, At length [in 1623] after much debate of things, the Gov. (with the advise of the cheefest amongst them) gave way that they should set corne every man for his owne perticuler, and in that regard trust to them selves. . . . And so assigned to every family a parcell of land . . .

“This had very good success; for it made all hands very industrious, so as much more corne was planted than other waise would have bene by any means the Gov. or any other could use, and saved him a great deall of trouble, and gave farr better contente.

“The women now wente willingly into the feild, and tooke their litle-ons with them to set corne, which before would aledg weakness, and inabilitie; whom to have compelled would have bene thought great tiranie and oppression.

“The experience that was had in this commone course and condition, tried sundrie years, and that amongst godly and sober men, may well evince the vanitie of that conceite of Platos and other ancients, applauded by some of later times;—that the taking away of propertie, and bringing in communitie into a comone wealth, would make them happy and flourishing; as if they were wiser than God. For this comunitie (so farr as it was) was found to breed much confusion and discontent, and retard much imployment that would have been to their benefite and comforte.

“For the yong-men that were most able and fitte for labour and service did repine that they should spend their time and streingth to worke for other mens wives and children, with out any recompense. The strong, or man of parts, had no more in devisiion of victails and cloaths, than he that was weake and not able to doe a quarter the other could; this was thought injustice. . . .

“And for men’s wives to be commanded to doe service for other men, as dressing their meate, washing their cloaths, etc., they deemd it a kind of slaverie, neither could many husbands well brooke it. . . .

“By this time harvest was come, and instead of famine, now God gave them plentie, and the face of things was changed, to the rejoycing of the harts of many, for which they blessed God. And the effect of their particuler [private] planting was well seene, for all had, one way and other, pretty well to bring the year aboute, and some of the abler sorte and more industrious had to spare, and sell to others, so as any generall wante or famine hath not been amongst them since to this day.”

The moral is too obvious to need elaboration. ❁

## Self-Perpetuating Pump Priming

July 4, 1949

Especially since its espousal in 1936 by John Maynard Keynes in his book *The General Theory of Employment, Interest and Money*, the doctrine of the “compensated economy” through government spending has played an ominous role. It has become a formidable weapon in the hands of the spenders and the statistes. These are in fact the same people. For wherever you find a man who wants more government power, you find a man who urges more government spending. And wherever you find a man who urges more government spending, you also find a man who believes in more government power.

In view of the dangerous “antirecession” spending schemes now being put forward, it is worth repeating the point made in this column of May 9, that even if



it were true that an inflationary budget deficit acted as a business stimulant, then producing that deficit through tax reduction would be at once more flexible, more effective, and less dangerous than producing it through higher government spending. Schemes for higher government spending always involve delays and lags both in getting them started and in getting them ended. Before new public-housing projects can be started, for example, there must be elaborate drawing up of plans and blueprints, selection of sites, condemnation proceedings or buying up of land, etc,

Once any government spending project has been started, moreover, it tends to become self-perpetuating. Let us suppose that the desired level of full activity and full employment has been achieved by government spending, so that any further government spending would simply bring price inflation. Nevertheless, the government just can't abandon a bridge half-suspended or a housing project at the halfway stage, without the roofs on. These projects must be finished, regardless of the economic effect of finishing them.

But the situation is usually far more serious than this. All those who have been employed on these projects, and above all the officials who have been put in charge of their direction and who have been handed more imposing jobs than they ever held before, will fight tooth and nail, night and day, for the retention of these jobs, offices, powers, and earnings. They will lay down a constant barrage of official propaganda calculated to drown out all disinterested criticism.

All these added government expenditures, ostensibly undertaken to give a transient spurt to business activity, then become permanent. The proportion of government to private jobs steadily increases. This is the history of European socialism and of present disorganized European budgets. It will also be our own history if we embark on still more reckless government spending now on the excuse of countering the existing recession.

If, however, the government were to try to make its "compensation" by reducing taxes, taxes could be reduced immediately. Moreover, Congress could easily provide in advance automatic standards under which taxes could be restored again the moment the stimulation of a tax cut was no longer necessary.

Even Keynesians and other government spenders will probably admit that cutting the taxes of the lower-income groups will result in these groups spending more money on consumption goods. But they will argue that this will not be at all the effect of reducing corporate taxes or the taxes of higher-income groups. These groups, they will contend, instead of spending

these "forgiven" taxes on consumption goods or investing them in expansion, will simply hoard the money.

But if there were any real prospect that these groups would hoard money instead of spending or investing it, wouldn't it be a good idea to go on to ask *why* they would hoard? They would hoard either because existing price-cost relationships were making business unprofitable or because impending or existing governmental policies had undermined confidence in the future profitability of business. ❁

## The Folly of Point Four: I

July 11, 1949

A speech that Secretary George C. Marshall made at Harvard a couple of years ago will cost us some \$17,000,000,000 before we are through. And Point Four, added as a final touch to President Truman's inaugural address to give it a little oomph, will cost us billions still incalculable.

In this column of April 11 I called attention to the striking parallel between Point Four and the proposal five years ago by Earl Browder, then head of the American Communists. This similarity is not accidental. Whether or not the proposals of Point Four stem directly from Browder's, they embody the same basic collectivist and statist assumptions.

There is nothing new in the belief that sound international investment promotes world production. The only thing "new" in the "bold new program" is the paternalistic assumption that this process of international investment must not be undertaken, as hitherto in modern times, by private investors at their own risk, to private borrowers who have proved their responsibility, but must be nursed, spoon-fed, furnished with crutches, and guided at every step by government.

Mr. Truman, following Earl Browder, assumes that it is our duty to raise the standards of living of the so-called "underdeveloped areas" all over the world. What he never mentions, and does not seem to realize, is that we can do this only by lowering our own standards of living, compared with what they would otherwise be. If our taxpayers are forced to contribute x millions of dollars for hydroelectric plants in Africa, they will obviously have that much less for more hydroelectric plants here. If we contribute x millions of dollars for a housing project in Uruguay, we will have just that much less left for housing, or any other equivalent, at home.

This simple principle that we cannot give our cake away and eat it too has been utterly ignored in the whole hullabaloo about Point Four. If the American people

are being urged to undertake Point Four primarily for charitable and humanitarian reasons, then they ought to be told in all candor that this charity will make them poorer and not richer. It is misleading to pretend that Point Four is at once a great charity and a shrewd way of selling more goods.

Yet Mr. Truman talks constantly as if we would grow richer by giving our capital away. "Our experience shows that the volume of our foreign trade is far greater with highly developed countries than it is with countries having a low standard of living and inadequate industry. To increase the output and the national income of the less developed regions is to increase our own economic stability." Now Tiffany's has also made the amazing discovery that it sells more to the rich than to the poor. But it has not yet occurred to the managers of that firm that it would increase its profits either by giving the poor the money to buy its jewelry or by making bad loans to them.

Another fallacy in Mr. Truman's message on Point Four is his assumption that investment in backward or "underdeveloped areas" must necessarily increase world production or wealth more than the same investment in advanced areas. On the contrary, advanced industrial countries can more often utilize still more capital far more productively and efficiently than backward countries can utilize it.

Under free markets investors put their money wherever they see the prospect of greatest safety and greatest profitability. When private investors who are risking their own money are free to make their own decisions, that capital is likely to be placed where it is most efficient and productive. But if *government* officials or technicians, who will not be risking their own money but somebody else's, are going to decide just where our foreign investments ought to be placed, they cannot be expected to pay scrupulous attention either to the security or the relative profitability of the loans they advocate. On the contrary, if experience is any guide, their recommendations will be determined primarily by political considerations. ☸

## The Folly of Point Four: II

July 18, 1949

The basic assumptions of Point Four, like those of the Communist proposal by Earl Browder which it imitates, are collectivist and statist. This is evident throughout the text of Mr. Truman's message. It allows a role for private capital, but it is the role of a junior partner. Point Four "will call upon private enterprise . . . as *well* as the

government. . . . It will be necessary to utilize not only be resources of international agencies and the United States Government, but also the facilities and experience of private business," etc.

Private enterprise, which has now learned to be grateful for any role in Mr. Truman's great plans, is to be "encouraged." How? By authorizing the Export-Import Bank to "guarantee United States private capital . . . against the risks peculiar to those [foreign] investments. . . . Some investments may require only a guarantee against the danger of inconvertibility, others may need protection against the danger of expropriation and other dangers as well."

What is Mr. Truman here proposing? He is proposing that in order to induce American private investors to risk their funds abroad, we are to allow these private investors to keep the profits of their investments, but to force the American taxpayers to assume the losses. Such a proposition needs merely to be stated plainly to show that it would be preposterous and intolerable. The private investors and investment bankers who applaud this proposition are shortsighted beyond belief. It could only lead to the eventual nationalization of all foreign investment.

Such an arrangement, moreover, would not remove or in the least reduce the risks of foreign investment. It would merely *transfer* those risks from the investor to the taxpayer. Point Four exists on the assumption that government could do more to reduce such risks than private investors could. This is the exact reverse of the truth.

"We are negotiating agreements with other countries," says Mr. Truman, "to protect the American investor from unwarranted or discriminatory treatment under the laws of the country in which he makes his investment." If a foreign government is prepared to deal honestly and fairly with private investment, foreign or domestic, we do not need such an agreement. If it is not, it will in one way or another violate or wriggle out of the agreement.

And what will our government do then? We do not need to ask. The history of the EGA already tells us. It will be afraid to do practically anything at all. For the most timid and delicate hints on the part of our government representatives will be denounced as outrageous "pressure" on the borrowing government, as interference in its internal affairs, as an effort to halt its glorious socialist planning, to reimpose a discredited capitalism, and so on.

Private investors, lending at their own risk, have a more effective way of dealing with such matters. They

do not dictate. They do not interfere. But as long as a foreign government levies confiscatory taxes, expropriates private property, socializes, nationalizes, imposes a strangling network of exchange and trade controls, or forbids its own nationals to repay their honest debts, private investors respectfully decline to make loans. They are not impressed by elaborate signed agreements to be honest, but only by an actual record of honesty.

It remains to be pointed out, finally, that our own government is itself heavily biased in favor of statism and socialism. Mr. Truman wants the Export-Import Bank to guarantee private capital against the risks of foreign lending. But the loans of that bank have been overwhelmingly government-to-government loans, or loans to government agencies, or loans with a government guarantee, and often for government projects directly competitive with private enterprise.

The Point Four program would inevitably drive the world farther into national socialism. ☸

## More Inflation to the Rescue

July 25, 1949

In his economic report of six months ago President Truman insisted on a further increase of taxes by \$4,000,000,000 a year. Today he declares: "No major increase in taxes should be undertaken at this time." In January he demanded stand-by price and wage controls, allocation of scarce materials, extension of bank-credit and installment-buying controls, and government construction of more steel capacity if private capital refused. The new report abandons these demands.

Mr. Truman's dramatic reversals are an admission that he was wrong on many things in January. But they do not necessarily prove that he is right now. In January he thought quite rightly that a budget surplus was "essential to sound fiscal policy." Today he thinks quite wrongly that "we cannot expect to achieve a budget surplus in a declining national economy." This implies that the cure for every recession is a new dose of deficit financing.

I cannot join those, therefore, who regard the abandonment of the \$4,000,000,000 tax demand as "reassuring." It would really have been reassuring if accompanied by a proposal for at least an equal cut in Federal expenditures. So would the proposals for repealing the tax on the transport of goods and for liberalizing the carry-over of losses by corporations. But as they stand, these proposals are merely part of a program

to give the American economy still another inflationary shot in the arm.

The President talks of his "anti-inflation program" of last January. This is an illusion. He never had an anti-inflation program. All he had was a program for more government controls to try to conceal the unpopular symptoms and consequences of monetary inflation. Even when Mr. Truman was "fighting inflation" by rhetoric, the government was conducting a highly inflationary bond-pegging program. As a corollary of this, it was following an inflationary cheap-money policy. The Federal Reserve authorities, though they wanted to control everyone else, fought tooth and nail the suggestion that Congress restore the reserve banks' own reserve ratio to its former 40 percent instead of the "emergency" 25 percent. And even when Mr. Truman was ostensibly "fighting inflation," he insisted on the biggest peacetime spending ever embarked upon by any nation in the history of the world.

But monetary inflation can keep a boom at its peak only if it goes on at an accelerative rate. There was a lull in our monetary inflation, and there then set in a "stabilization crisis," though so far a mild one. And the only answer that Mr. Truman and his advisers can think of is another inflationary spree. Though Mr. Truman claims that we are "still operating at high levels of employment and production," he nonetheless wants to embark on more deficit financing. Government economy is "out of the question." "Nothing could represent greater economic folly," in fact, than to cut government spending now.

Mr. Truman blandly tells us that a \$42,000,000,000 annual budget, five times the peacetime budget even of the Roosevelt regime, is a "minimum." He praises government extravagance: "The fact that public expenditures of Federal, state, and local governments are running at a rate of close to \$60,000,000,000 a year is itself an element of great stability in the present situation." Public expenditures of \$120,000,000,000 one gathers, would provide twice as much stability.

The President and his advisers fail to recognize the elementary fact that the more the government spends the less the individual taxpayer has left to spend. Their public spending programs make no addition to real spending power. These programs can seem to work only as long as they create government deficits financed by printing more money. This leads to the higher living costs that Mr. Truman and his advisers affect to deplore.

Mr. Truman's midyear economic report reflects throughout a super-Keynesian, inflationist, controlist, and statist philosophy. And that is not "reassuring." ☸



## Forcing a Fourth Round

August 1, 1949

President Truman has now been persuaded that the only way to cure even a mild recession is to start still another orgy of government spending and monetary inflation. "The fact," he declares, "that public expenditures of Federal, state, and local governments are running at a rate of close to \$60,000,000,000 a year is itself an element of great stability in the present situation." The fact is that these fantastic expenditures are precisely the greatest element of instability in the present domestic situation. When the Federal government has a balanced budget, its expenditures obviously create no new purchasing power of any kind. Before it spends \$40,000,000,000 a year, it must first of all take this amount from the nation's taxpayers. When politically favored groups have \$20,000,000,000 more to spend, the taxpayers who earned it have \$20,000,000,000 less.

Not only does huge government spending fail to stimulate real purchasing power and production: it destroys them. For the drastic taxes inevitably penalize precisely the productive elements in the nation. Such taxes not only destroy the incentive to produce and invest; they destroy even the ability to invest by seizing the very funds available for investment.

The government can, of course, as Mr. Truman suggests, deliberately resume deficit financing. This could create more monetary purchasing power, but only by printing more money. Debauching the currency is the oldest and most discredited trick in the world. And this is all there is to the much-touted "Keynesian revolution" when you take its sophisticated clothes off.

False remedies always divert attention from real remedies. The present is no exception. When business becomes stagnant, when unemployment sets in, it is usually because disequilibrium and distortions have developed within the cost-price structure. Some goods have been forced up to price levels where consumers will no longer buy them in the former volume. Production therefore declines: workers are laid off. These high price levels are commonly the result of high costs, the most important of which are wages. Excessive wage levels must force unemployment.

It is typical of Mr. Truman's spend-and-spend program that he wants to pour government money into the industries and sections where unemployment exists without even stopping to inquire how that unemployment came about. Instead of asking, for example, whether new private housing is being priced out of a full-volume market because of excessive wages and unproductive labor in the building trades, Mr. Truman

simply demands that the taxpayers be forced to subsidize these unprecedented wages through public-housing subsidies.

When excessive wage costs in other lines are forcing slowdowns in those lines, Mr. Truman's solution is to force up their labor costs still further. He wants to increase minimum wages overnight by 87½ percent. As workers above the minimum will insist on the maintenance of existing differentials, this would force up wages all along the line. And, finally, he has forced the steel companies to go before a "fact-finding" board which if it follows the precedents of all his previous boards, will recommend still another boost in wages. And this will set a new national pattern for a fourth round.

Monetary inflation gets its vaunted "full employment" results only as long as it keeps selling prices soaring far enough ahead of wages to increase or retain profit incentives. Its essential trick is to increase monetary wages while decreasing real wages. If the Truman Administration now launches on another monetary inflation, but tries to offset the resulting price rises by still faster boosts in wages, there is no telling where the seesaw race will eventually carry us.

There was no real economic crisis in this country until Mr. Truman insisted on policies that would present us with one. The chief thing we have to fear is his "cure" itself. ⚙

## The Economics of Arms Aid

August 8, 1949

If we may judge from the history of the ECA, it is not likely that the economic side of the proposed Foreign Military Assistance Act will be intelligently or adequately considered. Yet in spite of its military and political aspects, the whole proposal rests on the essentially economic argument that the other nations in the Atlantic Pact are unable to pay for their own armament. And this contention is not supported either by common sense or by the facts.

Mr. Truman offers Congress the very fragmentary piece of information that eight out of the eleven nations in the Atlantic Pact now have total annual military expenditures equivalent to \$5,500,000,000. "This," he insists, "is the maximum amount they are able to spend" without self-injury. How does he know that? His own country alone is already spending nearly three times as much on armament as these eight nations combined—in other words, about as much as 22 such nations. Yet Mr. Truman still doesn't consider this a maximum for



us. On the contrary, he wants us in addition to take over part of the burden of the others.

If Congress will inquire, it will find that the total amount of \$1,450, 000,000 we are supposed to contribute in the first year is equal to only about 4 percent of the total government expenditures of the other nations in the Atlantic Pact. It would not seem impossible for these other countries either to increase their total budgets by 4 percent—or, better, to take that amount out of their swollen nonmilitary expenditures. Their other government expenditures are, in fact, about four times as great as their military expenditures. And these sums are being spent, among other things, on expanded social-security programs, huge food subsidies, and above all on huge deficits in socialized industries.

Mr. Truman thinks other nations need part of these funds from us for “certain items essential for their defense which they are not equipped to provide for themselves.” This argument, though often used, has no merit.

They can buy these items from us and pay for them with other items. In short, they can pay for imports with exports—or rather they could do so if they had not deliberately unbalanced their economics and their foreign trade with their own exchange controls and overvalued currencies. Our own country does not produce for itself enough tin, natural rubber, or uranium; but it does not occur to us to use that as an excuse to demand these things as *gifts* from other countries.

As I have already pointed out in previous articles (April 4, May 30, and June 13), there is no way in which we can insure that either the money or the equipment we contribute under an arms-aid program would actually result in a net increase of European armament by that amount. For to the extent that we pay for the armament of European governments, we release just that much more of their own funds for other expenditures. The only way we could prevent this result would be to dictate every European government expenditure—a course which I, for one, would not recommend.

Looking at the matter the other way round, it should be equally obvious that our Marshall-Plan funds, though spent on other things, have freed just that much of Europe's own funds for armament. Instead of throwing still further funds in the direction of Europe, therefore, Congress could merely authorize Atlantic Pact nations to use up to, say, \$1,450,000,000 of their ECA credit for military expenditures.

The so-called military-aid program, in short, involves precisely the same broad economic issues as the Marshall Plan. We are weakening ourselves to give continuous and futile blood transfusions to Europe while

Europe does nothing to stop its socialistic hemorrhage. Our own officials don't dare to be specific about the European policies producing this hemorrhage. Their principle seems to be: “Europe's economic policies are none of our affair; therefore we must pay for its deficits.” ❁

## Wrong Diagnosis, Wrong Remedy

August 15, 1949

The Administration's diagnosis of this (and every other) recession and its suggested cure are based on an ultra-Keynesian ideology. Recessions or depressions, the Administration now implies (following Keynes, who was following Marx), are caused by a falling off or deficiency of consumer buying power, especially of worker buying power. Therefore the cure is simple. Have the government pump more buying power into the system: force up wage rates further, launch still more “public works,” spend the taxpayers' money lavishly, run into deficits, expand credit, and print more money.

The government's own official statistics now discredit its analysis and its remedies. What happened in the first half of this year? Did workers' incomes drop? No, concedes Mr. Truman in his midyear economic report: “Real earnings generally were maintained.” Then did total consumer income drop? No, again: “Personal income of consumers after taxes decreased only about 1 percent from the level of the last half of 1948. Since consumers' prices dropped 2 percent, real income did not change significantly.”

Did the government neglect to run into deficits? Still no. “Cash payments by the Federal government ran at a rate more than 20 percent higher than in the first half of 1948. . . . All governmental units combined showed a cash deficit in the first half of 1949 at a seasonably adjusted annual rate of \$2,400,000,000, in contrast to a surplus at a rate of \$12,100,000,000 in the corresponding period of 1948.”

Yet the government's proposed remedies today are a still further boost in wages “to maintain the purchasing power of workers,” “positive actions . . . to enlarge consumer purchasing power,” bigger government spending, and bigger deficits. Cuts are to be made at only two points—prices and profits. “While price reductions are desirable,” says Mr. Truman, “they should not be attained at the expense of wage cutting. . . . Businessmen have a great opportunity to maintain production and sales volume by adjusting prices downward, even at the cost of temporarily reduced profits.”

The Administration, in short, has two distinct sets of economic principles—one for prices and the exact reverse for wages. It sees that excessive prices reduce volume of sales. But it refuses to admit that for precisely the same reasons excessive wage rates create unemployment. As the leading element in costs, excessive wage rates must either force up prices to the point where sales volume drops, or wipe out profit margins.

In the first three months of this year profits of manufacturing corporations after taxes averaged about 6 cents in every dollar of sales. Not a very fat margin to tamper with, even if it were uniform. But this 6 cent average concealed a variation between industries ranging from 10.3 cents in petroleum and coal products down to 2.2 cents in leather products. And it concealed, of course, far wider variations among particular firms.

When profits are reduced, therefore, even “temporarily,” it doesn’t mean that businessmen accept a narrower uniform profit margin. It means that the profits of the marginal firms are wiped out altogether. They turn into losses. Losses force shutdowns. It is this that creates unemployment. This unemployment means that the total income and purchasing power of the wage earners is not increased but drastically reduced by excessively high wage rates. The Administration’s wage-boosting policy can only intensify the very unemployment and recession that it is supposed to combat.

“The only ultimate source of sustained profits,” says the President, “is sustained employment and purchasing power.” This puts the cart before the horse. The truth the Administration has forgotten is that the only ultimate source of sustained employment and purchasing power is sustained profits. You do not achieve full employment by destroying the rewards and incentives of the very people who provide employment. ❁

## Legislating Unemployment

August 22, 1949

The best prices are the prices that enable the largest possible volume of goods to be produced and sold. The best wage rates are the highest wage rates under which full employment is possible. In some lines wage rates have already been forced above this level. That is largely why we now have an estimated unemployment of about 4,000,000.

But exactly at this time the Administration seems bent on forcing still more unemployment by forcing wage rates still higher. Its theory is that higher wage rates under no matter what circumstances increase the income of labor and increase prosperity by increasing

labor’s “purchasing power.” This belief is political in origin. No one holds it about other prices. There it is clearly recognized that excessive prices cause goods to remain unsold.

But in the same way excessive wage rates, which mean prohibitive production costs, force employers to drop workers or to shut down altogether. Those workers fortunate enough to be kept on may, it is true, individually get more income and purchasing power than before. But greater unemployment means that the body of workers as a whole has less income and purchasing power.

Present unemployment is a caution sign, a danger signal. But the Administration treats it as a signal to drive full speed ahead toward still higher wage rates. It is encouraging a fourth round. And Congress is in the process of boosting the Federal minimum wage from the present 40 cents an hour to 75. This would mean an overnight increase of 87½ percent. Indirectly this measure will boost wages all along the line; for workers above the minimum will insist on the maintenance of their existing differentials.

On top of this Secretary of Labor Tobin, ostensibly acting under the Walsh-Healey Act, is forcing wages in special regions and industries to levels undreamed of even by the supporters of the new minimum-wage bill. He recently fixed a minimum of \$1.23 an hour, for example, in Northern steel mills working on government contracts.

Now it makes no sense from any standpoint to have *two* Federal minimum-wage laws, under one of which a minimum wage can be fixed 207½ percent higher than under the other. (This \$1.23 rate would still be 64 percent higher even if a 75-cent general minimum were enacted.) Under what social or equalitarian theory does the government bestow such glaring favoritism on the workers of firms who happen to get government contracts and discriminate so grossly against the workers of firms that do not?

If it didn’t seem too much to hope for under the prevailing ideology, one might suggest that Congress could considerably mitigate the harm it is about to do with a 75-cent minimum wage law by inserting at least two major amendments. The first would completely repeal the needless and mischievous Walsh-Healey Act. The second would remove the joker in the present law under which employers are penalized 50 percent for overtime above 40 hours a week, no matter what regular wage rate they pay. Under this joker precisely those employers are penalized most who already pay most, and precisely those workers are rewarded most who already get most. It is this joker that has brought all workers, and

not merely marginal workers, under Federal control. It has led to all the mischievous portal-to-portal and over-time-on-over-time rulings and decisions.

All this costly nonsense could be ended if Congress simply fixed the legal minimum overtime rate 50 percent higher than the legal *minimum* straight-time wage—instead of, as now, 50 percent higher than whatever straight-time rate a particular employer happens to pay. For example, if the new legal minimum straight-time rate is raised to 75 cents an hour, then the legal minimum overtime rate would be fixed at a flat \$1.12½ an hour. Any wages above these minimums would be determined by free bargaining. ❁

## When Government Fixes Wages

August 29, 1949

The Taft-Hartley Act specifically provides that “when, in the opinion of the President . . . a threatened or actual strike . . . will, if permitted to occur or continue, imperil the national health or safety, he may appoint a board of inquiry to inquire into the issues involved in the dispute and to make a written report to him within such time as he shall prescribe. Such report shall include a statement of the facts . . . but shall not contain any recommendations.” In the face of this explicit direction, President Truman insisted on appointing a board of inquiry that *would* make recommendations.

Naïve faith in the value of government “fact-finding” boards in wage disputes begins to dissolve as soon as we ask what facts there are to find. The facts of the past or present, regarding comparative living costs, wage rates, profits, and so on, are already known before any board is appointed.

Thus, according to already extant government statistics, we know that weekly wages in the steel industry averaged \$63.14 in May, more than \$10 above the general average for all manufacturing industries. We know that average hourly wages in steelworks in May were \$1.63, about 26 cents higher than the average in all manufacturing industries. We know that weekly steel wages in May were 111 percent higher than the average for 1939 and the cost-of-living index only 70 percent higher, so that “real” weekly steel wages this May were 24 percent higher than the 1939 average. We know that steel prices in June had advanced only 72 percent over 1939, compared with a 100 percent rise for all commodities. We know that steel profits are fickle and that in 1948 they averaged after taxes about 7½ cents per dollar of sales.

These are past and present facts. They do not make a fourth-round steel wage increase seem imperative. But whether the steel industry can afford a still further wage increase depends not upon past but upon *future* facts. And these are precisely the facts that no government board can know.

It might guess, of course. On the basis of past performance, it might judge which guesses seem reasonable and which seem absurd. Robert R. Nathan guesses that the steel industry could break even when operating at only 33 percent of capacity under June 1949 conditions. Let’s see. In the second quarter of this year steel operations dropped to an average of 91 percent of capacity (and to 82 percent in June). Yet Jones & Laughlin’s profits, as compared with the first quarter, dropped 46 percent, Crucible’s dropped 86 percent, and Allegheny Ludlum’s dropped 99 percent. We can only conclude that on its face Nathan’s guess is preposterous.

But how can any government board know just how much any given wage increase will cut future profits in steel? Or precisely how it will affect individual companies? Or exactly how much it will force up steel prices? Or just how much any given increase in steel prices will reduce sales and output? Or just how much unemployment this reduction will cause in the steel and other industries? Or how much all this will affect the ability of the industry to maintain or expand its plant, or the future willingness of new investors to risk their funds in any expansion of steel capacity?

All these questions are asked on the assumption that such boards would act with complete economic objectivity and not, as in the past, merely to buy off a strike, or to hold the labor vote, or to pay a political debt.

“Fact finding” and “recommendations” by government boards are intended to bring such pressure on the parties to a labor dispute, particularly the employers, as to amount in effect to compulsory arbitration. This in turn is only another name for government wage fixing. If government boards know how to set steel wages, then they know how to set all wages and all prices; and we may as well embrace totalitarianism now, with our eyes open, as stumble into it half-blindly, while mumbling lip service to free enterprise. ❁

## Abolish Exchange Control

September 5, 1949

The first need today of Britain and every other country that complains of a “dollar shortage” is the abolition of exchange control. This single step would put an end virtually overnight to the whole so-called “dollar crisis.”



Yet this crisis is being discussed today in an incredible atmosphere of unreality. The bureaucrats of the world can think of nothing but more “austerity” or more and bigger American handouts. Not a single one of them proposes to repeal the measure primarily responsible for the whole exchange nightmare—the exchange controls that they themselves have imposed in order to maintain a fictitious value for their own currencies.

The British socialists, for example, insist on maintaining at all costs the fiction that the pound sterling is worth \$4.03. They have made it a crime for their own citizens to buy or sell sterling below this rate. They forbid their own consumers to buy the foreign goods (or even the British goods) they want, but only what the bureaucrats tell them they can have. They compel British manufacturers to set aside for export minimum percentages of their output. They police the “cross rates” between the pound and the dollar throughout the world. They have succeeded in persuading American bureaucrats to turn over billions of American taxpayers’ dollars to try to plug up the gap that exchange control creates. Yet the sterling crisis grows steadily worse. One triumph of semantic confusion the British bureaucrats can boast. They have succeeded in getting the world to call the pound crisis a “dollar crisis.”

Suppose the whole worldwide exchange-control mechanism were simply dismantled and the pound allowed to sell for what it would bring in free markets. It would fall, let us say, to around \$3. The exporter of a British item that now sells in this market for \$4 could then afford to sell it for \$3. He would still get £1 for it, as before. If \$4 prices the item out of the American market, \$3 might price it back in again.

Or suppose that \$4 were a competitive price here but that it cost the British manufacturer £1.1\* to make the item. Then at \$4 to the pound he could sell this item here only at a loss of £0.1, but at \$3 to the pound he would get £1.33 for it and so would make a profit of £0.23. In short, a lower price for the pound in dollars would increase not only the incentive of American consumers to buy British goods here but the incentive and ability of British producers to sell them here.

British imports, it is true, would cost more—but in pounds, not in dollars. Higher prices in pounds would cause British consumers automatically to cut down on their purchases of foreign goods. They would no longer need coercive import quotas and prohibitions to make them “conserve dollars.”

Yet instead of merely returning to the system of free exchanges that prevailed immemorially and almost universally (outside of Stalinist Russia and Hitlerite Germany) until ten years ago, the bureaucrats of the

world now hotly urge still more false remedies for this crisis of their own creation.

It is fashionable even for British Conservatives and American officials to say today, for example, that what Britain is suffering from is excessive production costs and that these must be brought down for Britain to “compete.” But this disregards the prohibitive price handicap now put on British exports by the fictitious \$4 pound. And it also ignores the law of comparative costs, which one used to suppose that every economist since Ricardo understood. Under free-exchange rates high British production costs would be compensated by a lower quotation for the pound. For Britain to try to adjust its whole cost and price level to its spurious exchange rate would be (to borrow a simile from Wilhelm Röpke) like shoving a grand piano over to a misplaced stool instead of adjusting the stool to the piano.

It is correct to say that British collectivism and controls are responsible for Britain’s present crisis. But the keystone of this collectivism is exchange control. And that is why exchange control is the last thing that Sir Stafford Cripps is willing to surrender.

[\*Decimal-pound amounts were shown as shillings and pence in the original.—Ed.] ❀

## Collapse of a Trick Solution

September 12, 1949

Exchange control is a totalitarian device adopted by Communist Russia and systematized by Nazi Germany. As a general practice it is less than ten years old. Yet it is now so much taken for granted that commentators on the sterling crisis ignore its existence. Those who insist that the main solution is for Britain to cut its production costs in order to compete abroad overlook the enormous price barrier to export caused by a fictitious value for the pound. They want to saw off the piano legs instead of adjusting the height of the stool.

A similar false solution, whose proponents likewise pride themselves on their “realism,” is that Britain must “increase its production.” But if official statistics are trustworthy, this is what it is already doing. Britain’s index of industrial production advanced from 101 in 1935–38 and 100 in 1946 to 121 in 1948 and 133 in May of this year. As contrasted with such gains, our dollar aid to Britain under the Marshall Plan in the last fiscal year was only about 2½ percent of the total British national income.

Why should Marshall-Plan aid of only £245,000,000 a year count for so much, and the officially estimated increase in Britain’s national income of



£1,275,000,000 since 1947 count for so little? Britain's trade-balance deficit (including "invisible" items) in 1947 was £630,000,000. Why hasn't this been more than wiped out by the estimated annual increase since then of £1,425,000,000 in Britain's gross national product?

Although it has escaped the British bureaucrats, the answer to this puzzle ought to be obvious. The increase in Britain's production has not gone primarily into exports. On the contrary, in spite of the best bureaucratic intentions, it has gone almost entirely into increased home consumption. It has done this because distorted price incentives and price deterrents have directed consumption into imports, and production into domestic rather than export goods. And it is precisely exchange control that has brought about these perverted price incentives and price deterrents.

The answer is to abolish exchange control, and let the pound fall to its real market level. Yet so perverted has thought itself become on this subject that this simple restoration of freedom is being dismissed as a "trick solution." The real trick solution has been exchange control with its effort to prop up the pound to the fictitious level of \$4.03. That solution has failed disastrously.

The issue is further confused by the current use of the word "devaluation" in at least three different senses:

1—To mean a cut in the official rate of the pound below its present real market value and real purchasing power. I know of no responsible person who is seriously proposing this.

2—To mean that Britain would keep exchange control but lower the "official" rate of the pound to correspond with its supposed present "real value" in terms of other currencies. This would mean an immediate improvement. But it would be at best a temporary solution and would retain the evils of exchange control.

3—To mean the simple removal of exchange control. This would allow the pound (and every other currency) to seek its market level. Only this would show what the "real" value of each currency was. Only this would bring a constant balance of supply and demand, the end of "dollar shortage" or "hard" currency shortage, a restored balance of international payments, real convertibility of currencies, and restored multilateral trade.

"But," it will be objected, "if we leave the quotations of currencies merely to the play of supply and demand, they will become unstable." The answer is that they already are. Exchange control is merely a discredited effort to hide their instability. The world can never get back to real monetary stability until it returns to a real international gold standard.

But that's another story. We must do first things first. Abolish exchange control. ☸

## The Case for Capitalism

September 19, 1949

There has just been published by the Yale University Press a book that is destined to become a landmark in the progress of economics. Its title is *Human Action*, and its author is Ludwig von Mises. It is the consummation of half a century of experience, study, and rigorous thought.

No living writer has a more thorough knowledge of the history and literature of economics than Mises, and yet no living writer has been to more pains to take no solution of any problem on faith, but to think out each solution, step by verified step, for himself. The result is a work of great originality written in a great tradition. Although it builds on what was sound in the classical economists and on the revolutionary revision of Menger, Böhm-Bawerk, Jevons, Clark, and Wicksteed, it extends beyond any previous work the logical unity and precision of modern economic analysis.

I know of no other work, in fact, which conveys to the reader so clear an insight into the intimate interconnectedness of all economic phenomena. It makes us recognize why it is impossible to study or understand "collective bargaining" or "labor problems" in isolation; or to understand wages apart from prices or from interest rates or from profits and losses, or to understand any of these apart from all the rest, or the price of any one thing apart from the prices of other things.

It makes us see why those who specialize merely in "monetary economics" or "agricultural economics" or "labor economics" or "business forecasting" so often go astray.

So far is Mises's approach from that of the specialist that he treats economics itself as merely part (though the hitherto best-elaborated part) of a more universal science, "praxeology," or "the science of every kind of human action." This is the key to his title and to his 889 comprehensive pages.

Mises is so concerned to lay foundations of his work with unassailable solidity that he devotes the first 142 pages to a discussion of "epistemological" problems alone. This is apt to discourage all but the most serious students of the subject. Yet there is nothing pretentious or pedantic in Mises's writing. His sentences and vocabulary are as simple and clear as his profundity and closely woven logic will permit. Once his more abstract

theoretical foundations have been laid his chapters are models of lucidity and vigor.

Outstanding among his many original contributions are his “circulation credit” theory of business cycles, which emphasizes the harm of cheap-money policies, and his demonstration that partial socialism is parasitic on capitalism and that a complete socialism would not even know how to solve the problem of economic calculation.

This book is in fact, as the publishers declare, the counterweight of Marx’s *Das Kapital*, of Lord Keynes’s *General Theory*, and of countless other books recommending socialization, collectivist planning, credit expansion, and similar panaceas. Mises recognizes inflationism under its most sophisticated disguises. He demonstrates repeatedly how statist interventions in the market economy bring about consequences which even from the standpoint of those who originally advocated the interventions, are worse than the state of affairs they were designed to improve.

*Human Action* is, in short, at once the most unpromising and the most rigorously reasoned statement of the case for capitalism that has yet appeared. If any single book can turn the ideological tide that has been running in recent years so heavily toward statism, socialism, and totalitarianism, *Human Action* is that book. It should become the leading text of everyone who believes in freedom, in individualism, and in the ability of a free-market economy not only to outdistance any government planned system in the production of goods and services for the masses, but to promote and safeguard, as no collectivist tyranny can ever do, those intellectual, cultural, and moral values upon which all civilization ultimately rests. ❁

## Camouflaged Fourth Round

September 26, 1949

The report of the President’s special Steel Industry Board was an adroit political document. For those who were content to bounce along the headlines, it carried a fine air of “impartiality.” It is not surprising that so many editorial writers hastened to acclaim the board for its “statesmanship.”

The board did, indeed, make some unexpected concessions to the industry’s case. It admitted that its profits were “volatile.” It pointed out a number of fallacies in the unions’ “productivity” and “purchasing power” arguments. It found that “there are no inequities of steelworkers at present which require redress through a general wage-rate increase.” And on the ground that

“it seems desirable at this time to stabilize the level of wage rates,” it rejected the union’s demands for a straight wage increase.

But the board then immediately turned around and approved pension and insurance benefits which by its own admissions were equivalent to a wage increase of from 8 to 10 cents an hour. Just why it would be so bad for the steelworkers to get another pay boost in the form of a straightforward hourly increase, and just why it would be so good for them to be forced to take it only in the form of pension and *insurance* benefits, the report never made clear. Following a befuddled argument, it rejected a “general increase in rates of pay” for the puzzling reason that it is “just as likely to affect output and employment unfavorably as it is to affect them favorably.” One would suppose from this that if the chances were equal, the steelworkers should be entitled to the benefit of the doubt.

The real argument against a fourth round pay increase is, of course, that to force a further increase in production costs now would tend only to *reduce* output and employment. But this argument is just as strong against an insurance and pension boost equivalent to 8 to 10 cents an hour. It is, in fact, stronger. For the moment the companies could no longer supply every worker with at least a 2,000 hour work year, the hourly cost of the insurance-pension plan would mount even higher. This would raise breakeven points even more than a straight wage increase and would intensify the cost problem of the companies in a recession. And even more serious, insurance-pension plans, as the board admits, “once installed, become more or less permanent.” In fact, if experience with John L. Lewis is any guide, forced pension plans to which employees do not contribute—and it is precisely such a plan that the board wishes to impose—are worked up to ever more costly and extravagant levels.

It is impossible to call attention here to all the *non sequiturs*, inconsistencies, and self-contradictions with which the report is riddled. Some random examples will have to do.

The board turns down a straightforward wage increase on the implied (though never clearly stated) ground that it would force price increases. But when it insists that the companies must add the equivalent of 8 to 10 cents an hour to their payrolls for insurance-pension plans, it not only assumes that this would be no excuse for a steel price increase, but implies that it would somehow be followed by “higher profits.” And if these “do not result in benefit to the consumer in the form of lower prices, there would be justification for the union to renew its demand for increase of wage rates!”

In other words, if one payroll boost doesn't bring down steel prices, try, try, again.

The board finds that a "social obligation . . . rests upon industry to provide insurance against the economic hazards of modern industrial life," but doesn't tell us who is going to insure industry itself against the economic hazards of modern industrial life.

The strangest paragraphs in the report are those in which the board affects to deplore "the habit of turning to government" to settle labor disputes "instead of arguing it out in collective bargaining." Now who on earth do you suppose appointed the board and forced the companies to go before it? ❀

## The World Monetary Earthquake

October 3, 1949

Within a single week 25 nations have deliberately slashed the values of their currencies. Nothing quite comparable with this has ever happened before in the history of the world.

This world monetary earthquake will carry many lessons. It ought to destroy forever the superstitious modern faith in the wisdom of governmental economic planners and monetary managers. This sudden and violent reversal proves that the monetary bureaucrats did not understand what they were doing in the preceding five years. Unfortunately it gives no good ground for supposing that they understand what they are doing now.

This column has been insisting for years, with perhaps tiresome reiteration, on the evil consequences of overvalued currencies. On Dec. 18, 1946, the International Monetary Fund contended that the trade deficits of European countries "would not be appreciably narrowed by changes in their currency parities." I wrote in *Newsweek* of March 3, 1947: "It is precisely because their currencies are ridiculously overvalued that the imports of these countries are overencouraged and their export industries cannot get started." In the issue of Sept. 8, 1947, as well as in my book *Will Dollars Save the World?* I wrote: "Nearly every currency in the world (with a few exceptions like the Swiss franc) is overvalued in terms of the dollar. It is precisely this overvaluation which brings about the so-called dollar scarcity."

Yet until Sept. 18 of this year the European bureaucrats continued to insist that their currencies were not overvalued and that even if they were this had nothing to do, or negligibly little to do, with their trade deficits and the "dollar shortage" that they continued to blame on America. And the tragedy was that

former Secretary of State Marshall, the President, and Congress, completely misunderstanding the real situation, accepted this European theory and poured billions of the American taxpayers' dollars into the hands of European governments to finance the trade deficits that they themselves were bringing about by their socialism and exchange controls with overvalued currencies.

In time the managers of the Monetary Fund learned half the lesson. They recognized that most European currencies were overvalued. They recognized that this overvaluation was a real factor in causing the so-called "dollar shortage" and unbalancing and choking world trade. But they proposed the wrong cure.

They did not ask for the simple abolition of exchange controls. (Their own organization in its very origin was tied up with the maintenance of exchange controls.) They proposed instead that official currency valuations be made "realistic." But the only "realistic" currency valuation (as long as a currency is not made freely convertible into a definite weight of gold) is the valuation that a free market would place upon it. Free-market rates are the only rates that keep demand and supply constantly in balance. They are the only rates that permit full and free convertibility of paper currencies into each other at all times.

Sir Stafford Cripps fought to the last against the idea that the rate of the pound had anything to do with the deepening British crisis. Trying to look and talk as much like God as possible, he dismissed all such contentions with celestial disdain. But at the eleventh hour he underwent an intellectual conversion that was almost appallingly complete. We "must try and create conditions," he said, "in which the sterling area is not prevented from earning the dollars we need. This change in the rate of exchange is one of those conditions and *the most important one*" (my italics). And on the theory that what's worth doing is worth overdoing, he slashed the par value of the pound overnight from \$4.03 to \$2.80.

There are strong reasons (which space does not permit me to spell out at this time) for concluding that the new pound parity he adopted was well below what the real free-market level of widely usable sterling was or would have been on the day he made the change. What he did, in other words, was not merely to adjust the pound to its market value as of Sept. 18 but to make a real devaluation.

The first consequence was to let loose a world scramble for competitive devaluation far beyond anything witnessed in the '30s. Most nations fixed new rates lower than their existing real price and cost levels called for. These countries, therefore, will now undergo



still another epidemic of suppressed inflation. Their internal prices and living costs will start to soar. Unions will strike for higher wages. And if the past (or Sir Stafford's Sept. 18 talk) is any guide, the governments will try to combat this by more internal price-fixing and rationing, continued or increased food subsidies, unbalanced budgets, and wage fixing.

In this country, on the contrary, the tendency will be to drag down our price level somewhat by lowering the dollar price of imported commodities and forcing reductions in the dollar price of export commodities. This will increase our problems at a time when the unions are pressing for a wage increase in the camouflaged form of insurance-pension benefits.

It will be necessary to reexamine our whole foreign economic policy in the light of the new exchange rates. Marshall-Plan aid with overvalued European currencies was largely futile; Marshall-Plan aid with undervalued European currencies should be unnecessary. In fact, we may soon witness the reversal of the world flow of gold. For the first time since 1933 (if we omit the war years 1944 and 1945) gold may move away from, instead of toward, our shores.

But getting rid of overvalued currencies, even in the wrong way, is nonetheless a tremendous gain. The chief barrier that has held up a two-way flow of world trade in the last five years has at last been broken. The chief excuses for maintaining the strangling worldwide network of trade restrictions and controls have at last been destroyed. Were it not for the echoes of the atomic explosion in Russia, the outlook for world economic freedom would at last be brighter.

The best British comment I have read since the devaluation comes from The London *Daily Express*: "Let every foreign country pay what it thinks the pound is worth. . . . But the socialists will never consent to free the pound. It would mean abandonment of their system of controls. . . . If you set money free you set the people free." ❁

## Fourth Round in a False Face

October 10, 1949

The report of the President's steel-industry fact-finding board was a crazy quilt of self-contradictions.

The central self-contradiction consisted in rejecting another wage increase while accepting insurance and pension benefits that by the board's own admission were the equivalent of an increase of 8 to 10 cents in hourly wage rates.

The arithmetic and logic of the case ought to be as plain as daylight. If at this time the steel companies can't afford another wage increase, they can't afford the added burden of an insurance and pension plan. If our economy as a whole can't afford another round of wage increases, it can't afford a new insurance-pension plan. If a wage increase would be "unstabilizing" now in the frank form of an increase in the hourly rate, it would be just as unstabilizing in the disguised form of an insurance-pension plan. If, on the other hand, the steel industry, or industry in general, *can* afford now to take on the added burden of an insurance-pension plan costing 10 cents an hour, it can just as well afford to take on a straight fourth-round wage increase of 10 cents an hour.

Why did the board's decision fly in the face of such elementary arithmetic? For purely political reasons? Because it wanted to grant a fourth-round wage increase but didn't want it to look like a fourth-round wage increase?

The board might have handed down one of two self-consistent decisions. It might have said to the union leaders: "The steel workers are at present earning an average of about \$1.65 an hour. We find that the steel industry cannot afford any further pay increase. It would only result in a rise of prices and a decline of sales, output, and employment. But you believe in compulsory insurance and pensions. So do we. Therefore we recommend that wage rates in the steel industry be reduced to \$1.55 cents an hour and that the companies set aside the 10-cent difference for a workers insurance and pension plan."

If any such decision had been handed down, the union leaders would have yelled bloody murder. Yet it would have carried out the implied premises of the board. It would have carried out logically, also, the specious analogy drawn by the board and the union leaders between insurance and pension plans for workers and depreciation charges for machines. For companies do not pay out to stockholders the entire current earnings of machines; they *withhold* part of those earnings for depreciation and replacement.

Another self-consistent decision the board might have made is this: "The steel workers are now getting an average of \$1.65 an hour. We find that the companies, without bringing on higher prices, disruption, or unemployment, could pay as high as the equivalent of \$1.75 an hour. It is up to the members of your unions whether they want to take the 10-cent addition in the form of a straight hourly wage boost or of insurance and pension benefits. It certainly isn't for us to force them to take it in one form rather than another." If this had



been the decision, would all the union members have chosen insurance and pension benefits?

Some companies have misconceived the central issue as one between contributory and noncontributory pension plans. They are right in believing that contributory plans, which are less subject to various abuses, are generally sounder than noncontributory. But this is a secondary issue.

The central issue now raised is this: Will the *total cost burden* placed on the steel and other industries by an insurance and pension plan, thrown on top of present wage rates, force up prices and so reduce sales, output, and employment?

The workers cannot in the long run get more than they produce. Whatever they get in insurance and pension benefits must in the long run be at the expense of their wage rates. In their new pension propaganda the union leaders may pull every stop in the emotional organ. But they cannot escape from arithmetic. ❁

## Illusions of 'Social Security'

October 17, 1949

Let's consider a few more self-contradictions in the President's steel fact-finding board report.

On page 61 we learn: "As to old age and unemployment . . . the government itself has stepped in to provide a minimum of protection." But two paragraphs later we are told: "No one seriously contends that those sums could have provided a minimum standard of living even back in 1935 when they were fixed." So they provided a minimum and they didn't.

Obviously those sums can't provide a minimum standard today, the board continues, "with the cost of living some 70 percent higher than in 1935." One might have expected the logical moral that so-called social-security schemes financed or accompanied by inflationary governmental policies are a cruel deception. No such moral is drawn.

Then the board turns angrily on the Federal government that created it. It appears that the existing pensions provided by that government are "un-American." Further: "Even if the increases now being discussed in the Congress were enacted, they still would not materially increase the purchasing power of the workers' pensions over the original purchasing power provided in 1935." In other words, they would still be un-American.

Turn now to page 62: "So long as government does not provide the security at all, we believe that industry should. So long as government fails to provide an adequate amount, industry should take up the slack." This

lily seems too lovely to gild. For sixteen years the New Dealers have been telling us that if industry doesn't live up to its "social responsibilities" government must do the job. Now they tell us that "no thoughtful citizen . . . can expect labor to wait patiently by until government makes up its mind." So private industry must take over these "social responsibilities" if government won't! This is statism biting its own tail.

Still on page 62: "Social insurance, at least in its minimal form, should be founded on a universal base for all workers in the United States." The board talks of "the danger of unbalanced, overlapping, and competing programs." It finds it a "cause of great concern" that "there is growing up haphazardly all over the country this large number of unequal and uncoordinated insurance funds, with little or no public control." All this would lead logically to a recommendation that the existing universal, "nationwide, compulsory" government insurance plan should be made "American" and "adequate." Instead, the board recommends still *more* unbalanced, overlapping, competing, haphazard, unequal, and uncoordinated private-insurance funds!

The government's social-insurance system is based on worker contributions. The board ignores this. For 67 pages it insists that the sole cost of pensions and insurance must be paid by the employer. But on page 68, in its eagerness to argue that such employer funds would not be raided or abused, it slips into a fatal admission: "So long as the cost of the plan is integrated into the labor cost structure . . . the worker will know that he is in fact paying for his own insurance." He must do so for the simple reason that he cannot in the long run be paid more than he earns. But then why deceive him? Why try to tell him in all the rest of the report that the burden of his insurance can in fact be shifted entirely on employers?

In this sudden emotional flim-flam about pensions little attention has been paid to the experience of Britain and France. The British cradle-to-grave social services are far more comprehensive, far more expensive, and provide a far greater percentage of the worker's real income than our own. In France the cost to the employer of social benefits has now reached a basic amount of 29 percent over and above wages, with even higher costs for particular firms and industries. But this crippling burden is precisely one of the reasons why the total income of the British or French worker is so much smaller than the American's.

One of the primary causes of the grave social insecurity of our time is this fetish called "social security." ❁

## Power of Industrywide Unions

October 24, 1949

Let's see just how we got into this. The President's steel fact-finding board handed down a proposed settlement not only unsound in itself but riddled with inconsistencies. Its central self-contradiction was to deny a straight hourly wage increase on the ground that this "might well cause price dislocations"—and then insist on a pension-insurance plan costing 8 or 10 cents an hour which would have the same economic effects as such a wage increase.

Soon or late the present industrywide steel and coal strikes will be settled. But any terms now acceptable to the unions are almost certain to increase production costs and to put further strains on the economy. They will either result in unemployment or in more inflation to make the higher costs payable.

The trouble is not merely that the President's board handed down a bad report, but that we cannot have government wage-fixing in this or any other disguise and still keep a free economic system.

Why was such a board appointed? In the fear that the industrywide steel union would otherwise bring the steel industry of the nation to a halt. And now that the steel industry and the soft-coal industry have both been brought to a halt by their respective industrywide unions, our whole economy is in danger of paralysis.

Let's go back a little farther. How did we get into the position where there *are* industrywide unions? How did we get to the point where individual unions have become so powerful that they can paralyze the entire economic life of the country unless their terms are met?

We got there precisely because the government helped to put us there. We got there precisely because the Federal government itself, through the Norris-LaGuardia and Wagner Acts, and continuing with the Taft-Hartley Act, deliberately turned itself into a union organizing agency, built up industrywide unions, and encouraged strikes by taking practically all the risks out of strikes.

One reason why the employers must now deal with the Murrys and Reuthers and Petrillos and Lewises, no matter how unreasonable or disrupting the demands of the latter may be is that they are *forced* to deal with them under the law. We deliberately grant a handful of union leaders the power to paralyze the nation's economic life, and then become surprised and indignant when they use the power.

As long as this legal grotesquery remains, we will have threats of economic paralysis until union

leadership at last makes it impossible for a free system to operate at all.

The straightforward solution would be the complete repeal of the Taft-Hartley Act (including, of course, the Wagner Act which it amends) and the repeal or drastic revision of the Norris-LaGuardia Act.

But no amount of economic disruption now seems sufficient to convince Congress that its predecessors made serious mistakes in 1932 and 1935. From the standpoint of creating a workable economic system or of bringing about industrial peace, the Norris-LaGuardia and Wagner Acts were not great forward steps but great backward steps. Yet even the timid Taft-Hartley revisions in 1947 have been denounced by Mr. Truman.

In this atmosphere any real solution seems impossible. But a minimum reform, if a free economic system is to be allowed to function, would be an amendment removing the present legal compulsion on employers to recognize and "bargain" with industrywide unions. Such an amendment was in the original 1947 House bill, which was passed by an overwhelming majority. It failed in the Senate by a single vote, and only because of the fear of a Presidential veto. If Mr. Truman were to recommend such an amendment now, he could get it immediately. Until he does, the country will remain in the power of industrywide unions, of these Frankenstein monsters given a special license to paralyze the nation's economic life if they don't get exactly what their leaders want. ❀

## Devaluation Instead of Freedom

October 31, 1949

Serious signs are appearing that sterling devaluation is not going to have the good results for which Sir Stafford Cripps had hoped. And the chief reason for this is that he will not permit free markets to function.

His first mistake was "devaluation" itself. What was called for, as Winston Churchill has hinted, was not an arbitrary slash in the "official" value of the pound but a return to free exchange rates.

Under a system of free rates, with Britons and foreigners exchanging pounds against other currencies at the relative valuations that they mutually agreed upon, the only way in which a government could sustain the value of its currency would be by taking the measures necessary to win confidence in it. But Sir Stafford preferred to have the value of the pound fixed, not by the people who trade in it, but by himself; not by confidence, but by fiat, coercion, and command.

Even this mistake would not have been irremediable if he had been willing to allow the new rate to produce its natural economic consequences. But it is precisely these consequences that he seems determined to prevent. “Nothing,” he says, “—and I mean literally nothing—should be done to increase personal incomes arising out of profits, wages, or salaries.” And again: No one must “try and profiteer or improve [his] relative position compared to [his] fellow citizens.” Sir Stafford wishes to retain what the British Socialists are fond of calling “fair shares for all.”

Now it is in fact only by the *relative* changes in prices, profits, and wages brought about by the new price of the pound that labor and capital could be voluntarily diverted from domestic production into export production. British manufacturers will produce more for export and less for home consumption only if they see a better prospect for profits in the foreign than in the domestic market. Manufacturers can bid labor away from domestic to export production only if they are able to offer, and permitted to offer, higher wages for export than for home production. This is precisely what a free market under the new sterling rate would enable them to do. This is how a free market works.

Sir Stafford either does not understand this or finds it abhorrent. He prefers government price fixing and government wage fixing. And like most government planners, he thinks of prices *en bloc* and of wages *en bloc*. He will not permit the thousands of necessary relative adjustments to be brought about by the free play of prices, profits, and wages in the market, with their corresponding effect on relative deterrents and incentives. Therefore he is forced to try to substitute the incomparably clumsier and less effective method of exhortations and compulsions. He forbids free-market incentives and then tries to substitute the paternalistic statist incentive of taxpayers’ guarantees against exporters’ losses.

It is open to doubt whether Sir Stafford understands even the direct market mechanics of devaluation. The only illustration he offered in his radio speech announcing devaluation assumed that a British export’s price in pounds remained fixed and that the full adjustment to the new pound rate was made by a lower price in dollars. If this were general, the British exporter’s advantage would be very slight. He would get no more pounds from a given volume of sales than before, and exporters collectively would have to sell 44 percent more goods in volume for Britain to earn the same number of dollars. But where the exporter could sell for the same *dollar* price as before, he could get 44 percent more pounds for the same sales volume—no negligible incentive. In

practice, in free markets, the final price adjustment for most exports (or imports) would tend to be made partly through higher sterling prices and partly through lower dollar prices.

In sum, though free exchange rates would be infinitely preferable to “devaluation,” neither free exchange rates nor devaluation can bring their desired results except within the framework of free markets and a free economy. ❁

## Collectivism Marches On

November 7, 1949

One of the strange perversions that have crept into our political life is the habit of praising Congress for the amount of legislation it has passed or denouncing it for “dawdling” when it passes little. One would think that the more new laws a Congress put on the books, the more things it meddled in, the more new restrictions and compulsions it put on the citizens, and the more it took from the taxpayers to hand to some special interest, the better.

President Truman called the 80th “the worst Congress ever” because he considered it a “do-nothing” Congress. He was wrong. The 80th Congress put no fewer than 1,363 new laws on the books. True, this was 263 less than the 79th; but it beat the 78th by 206. To catch up with the 80th, Mr. Truman’s more favored 81st will have to enact at least 526 laws more. In the nine-month session just closed it passed 837 bills.

Is it really possible for any President (who must approve or veto each of them) to decide within a few months on the individual merits of more than 800 separate bills? Is it possible for any congressman to do so—though he too is called upon to vote on all? And if no single human mind whatever is capable of judging the individual consequences of each of these hundreds of new laws, not to speak of their composite interaction, how can the net result be called intelligent, coherent, or responsible lawmaking?

So far from denouncing a do-nothing Congress, we might better pray for one. What the country needs is an undo-something Congress.

In trying to judge the record of the last session, we are compelled to center arbitrarily on a handful of items. On the credit side, Congress ratified the Atlantic Pact, extended the reciprocal-trade agreements, and adopted some of the Hoover recommendations for reorganizing the government. It commendably refused to throw out the Taft-Hartley Act in order to substitute something much worse, and it fortunately failed to plunge ahead



with Point Four, or to enact a new grab-bag social-security program, or to rush through compulsory health insurance. On the debit side, the cumulative record was alarming. The session adopted a housing bill that was both collectivistic in concept and inflationary in effect. It boosted the legal minimum wage from 40 cents to at least 75 cents an hour. This must either create unemployment for the very people it is intended to benefit, or force further inflation to prevent such a result. The session adopted a "compromise" price-support bill for farm commodities which constituted the most openly cynical and recklessly expensive bid for the farm vote ever made. It provided for additional storage facilities to withhold more foodstuffs from the American public, create artificial scarcities, and force consumers to pay higher prices.

It authorized \$5,600,000,000 more Marshall-Plan money without even requiring in return policies to promote freedom and recovery instead of collectivism and crises. It appropriated \$1,314,000,000 for arms aid on the false assumption that the recipient governments couldn't afford to pay for arms themselves. It spent more than \$46,000,000,000 and headed toward another deficit of \$5,000,000,000 to \$10,000,000,000.

In brief, the last session of Congress drove the country still farther toward collectivism and inflation. It assumed that every domestic and foreign problem could be solved simply by seizing still more from the American taxpayer and handing it over to someone else. The mere fact that the last session refused to drive even faster into collectivism should not blind us to how far it actually went.

Yet this Congress, which was so busy thinking of how many better uses it could make of the taxpayer's money than the taxpayer could, didn't find time to do anything to curb the power of the industrywide unions that Congress itself has built up. The private power of a handful of union bosses to paralyze the nation's entire economic life unless their demands are met seemed a matter too trivial for Congressional notice. It considered 700 other things more important. ❁

## Union Monopoly vs. Capitalism

November 14, 1949

It was inevitable from the start that when the steel and coal strikes were settled it would be essentially on the union leaders' terms. There may have been some doubt as to the exact amount by which they would force up labor costs, but there was never any doubt that would force them up.

Government mediators might hail the capitulation of Bethlehem Steel as a triumph for "voluntary procedures." But when an employer makes such concessions only after his plants have been closed down for a month by a strike, after a Presidential board has put the heat on him by "recommending" just such concessions, and when experience suggests the possibility of government seizure, it becomes hard for most of us to distinguish between such "voluntary" concessions and concessions made under duress.

As a result of the unrestrained power of industry-wide unions a new national pattern is being established under which employers will feel virtually compelled to add about 10 cents an hour to their wage costs.

This victory is likely to be a Pyrrhic one for labor itself. On top of the new minimum-wage boost, it will probably either bring about unemployment or force a further monetary inflation to make the higher labor costs payable. And even if that result doesn't come right now, we may be sure the national union leaders will keep repeating the pattern until it does.

The dangers of industrywide bargaining have been forcibly pointed out in a pamphlet by Prof. Leo Wolman of Columbia.\* They are now further emphasized in a book by Prof. Charles E. Lindblom of Yale†. It is Professor Lindblom's startling thesis that "unionism is destroying the competitive price system."

"The strike," he points out, "paralyzes production, and it is dramatic. But the real labor problem is its aftermath. For if wage disputes call a halt to production temporarily, their settlement may disorganize it permanently. Unionism will destroy the price system by what it wins rather than by the struggle to win it. It sabotages the competitive order, not because the economy cannot weather the disturbance of work stoppages but because it cannot produce high output and employment at union-wage rates."

What are we going to do about it? The first step is to get the public to recognize clearly the real nature of what is now happening. As Professor Wolman has summed it up, the industrywide unions "can today paralyze the economic life of the country or dictate the terms on which they refrain from doing so." The next step is to stop appointing so-called "fact-finding" boards whose decisions are inevitably political and who impose something close to government wage fixing. And the next step is to take away from any union leader the arbitrary power to bring on the kind of nationwide crisis that creates a demand for direct government intervention.

The original Hartley bill, passed by the House in 1947 by a vote of 308 to 107, removed the compulsion



on the employer to recognize and deal with industry-wide unions. If a union leader represented the workers of one employer, for example, the Labor Board was not to certify him as eligible to represent the workers of any competing employer, unless each employer regularly employed less than 100 men and the competing plants were less than 50 miles apart. A similar provision failed in the Senate by only a single vote.

If Congress were now to pass such an amendment to the Wagner-Taft-Hartley act, it would not undo, of course, all the damage its bad legislation has done. But it would be an excellent beginning. If even this is not made, we cannot escape Professor Lindblom's grim conclusion: "Union monopoly destroys the price system because it produces . . . waste, unemployment, inflation, or all combined . . . to a degree which the economy cannot survive."

\* *Industry-Wide Bargaining* (63 pages, Foundation for Economic Education, Irvington, N. Y., 75 cents).

† *Unions and Capitalism* (267 pages. Yale University Press, \$3.75). ❁

## What 'Monetary Management' Means

November 21, 1949

Before it has faded too far into the past, let's look at the record.

When Sir Stafford Cripps announced the devaluation of the pound, Winston Churchill pointed out that Cripps had previously denied any such possibility no fewer than nine times. A United Press dispatch of Sept. 18 listed nine such occasions. A haphazard search on my own part has uncovered three more—on Sept. 22 and 28, 1948, and April 30 of this year. Incorporating these in the UP list, we get the following record of denials:

Jan. 26, 1948—"No alteration in the value of sterling is contemplated by the British Government following the devaluation of the franc."

March 4, 1948—A reported plan to devalue the pound is "complete nonsense."

May 6, 1948—"The government has no intention of embarking on a program to devalue the pound."

Sept. 22, 1948—"There will be no devaluation of the pound sterling."

Sept. 28, 1948—The government has "no idea whatever" of devaluing the pound sterling. Devaluation would "increase the price of our imports and decrease the price of exports, which is exactly the opposite of what we are trying to accomplish."

Oct. 5, 1948—"Devaluation is neither advisable nor even possible in present conditions."

Dec. 31, 1948—"No one need fear devaluation of our currency in any circumstances."

April 30, 1949—"Sterling revaluation is neither necessary nor will it take place."

June 28, 1949—"There has been no pressure on me by America to devalue the pound."

July 6, 1949—"The government has not the slightest intention of devaluing the pound."

July 14, 1949—"No suggestion was made at the conference [with Snyder and Abbott] . . . that sterling be devalued. And that, I hope, is that."

Sept. 6, 1949—"I will stick to the . . . statement I made [July 14] in the House of Commons."

In brief, Sir Stafford emphatically denied at least a dozen times that he would do what he did. The excuse has been made for him that naturally he could not afford to admit any such intention in advance because no one would then have accepted sterling at \$4.03. This "defense" amounts to saying that unless the government had lied it could not have successfully deceived the buyers of British goods and the holders of sterling.

For this is what "devaluation" means. It is a confession of bankruptcy. To announce that IOU's hitherto guaranteed to be worth \$4.03 are in fact worth only \$2.80 is to tell your creditors that their old claims on you are now worth no more than 70 cents on the dollar.

When a private individual announces bankruptcy, he is thought to be disgraced. When a government does so, it acts as if it had brought off a brilliant coup. This is what our own government did in 1933 when it jauntily repudiated its promises to redeem its currency in gold. Here is how the *London Bankers' Magazine* describes the recent devaluation of the pound by the British Government: "The political technique for dealing with these issues has worn thin. It consists of strenuous, even vicious repudiation beforehand of any notion of devaluation. It insists that the move would be ineffective and utters portentous warning about the dangers. When the unthinkable happens the public is slapped on the back and congratulated on the best piece of luck it has encountered for years."

This is what governments have now been doing for a generation. It is the modern equivalent of medieval coin clipping. This is what "monetary management" really means. In practice it is merely a high-sounding euphemism for continuous currency debasement. It consists of constant lying in order to support constant swindling. Instead of automatic currencies based on gold people are forced to take managed currencies based on guile.

Instead of precious metals they hold paper promises whose value falls with every bureaucratic whim. And they are suavely assured that only hopelessly antiquated minds dream of returning to truth and honesty and solvency and gold. ❁

## Gold Goes with Freedom

November 28, 1949

The question whether or not it is desirable to return to a real gold standard, and when, and under what conditions, and at what rate, and by precisely what steps, has become so complicated that in spite of its great importance I have hitherto refrained from taking it up in these columns.

Fortunately an excellent take-off point is now provided by the speech of W. Randolph Burgess of the National City Bank of New York, before the American Bankers Association. His position seems to me, with one or two reservations, the most sensible and balanced recently presented. I quote in part:

“Historically one of the best protections of the value of money against the inroads of political spending was the gold standard—the redemption of money in gold on demand. This put a check-rein on the politician. For inflationary spending led to the loss of gold either by exports or by withdrawals by individuals who distrusted government policies. This was a kind of automatic limit on credit expansion. . . .

“Of course the modern economic planners don’t like the gold standard just because it does put a limit on their powers. . . . I have great confidence that the world will return to the gold standard in some form because the people in so many countries have learned that they need protection from the excesses of their political leaders. . . .

“There is a group of people today asking for the restoration of the full gold standard immediately in the United States. Today we have a dollar that is convertible into gold for foreign governments and central banks; these people are asking for the same rights to hold gold for our own citizens. In principle I believe these people are right, though I think they are wrong in their timing, and overemphasize the immediate benefits. . . .

“If you try to force the pace by resuming gold payments before the foundations are laid through government policies on the budget, on credit, and on prices, the gold released may simply move out into hoards and become the tool of the speculator.

“Gold payments are only part of the building of sound money, and they are in a sense the capstone of the arch. . . .”

The great virtue of this statement is not only that it recognizes the central importance of returning to a real gold standard but that it takes account also of the formidable difficulties that our past and present errors and sins have placed in the way.

For the gold standard is not important as an isolated gadget but only as an integral part of a whole economic system. Just as “managed” paper money goes with a statist and collectivist philosophy, with government “planning,” with a coercive economy in which the citizen is always at the mercy of bureaucratic caprice, so the gold standard is an integral part of a free-enterprise economy under which governments respect private property, economize in spending, balance their budgets, keep their promises, and refuse to connive in over-expansion of money or credit. Until our government is prepared to return to this system in its entirety and has given evidence of this intention by its deeds, it is pointless to try to force it to go on a real gold basis. For it would only be off again in a few months. And, as in the past, the gold standard itself, rather than the abuses that destroyed it, would get the popular blame.

Last week I recited the shabby record of Sir Stafford Cripps, not as a personal criticism but as an illustration of what typically, if not inevitably, happens under a “managed” paper-money system. For Sir Stafford is not the lowest type of politician likely to be entrusted to manage the people’s money; he is the highest type. To millions he had been the very symbol of political integrity and courage. “If gold rusts,” as Chaucer asked, “what shal iren do?”

Which reminds us that real gold doesn’t rust. As a currency basis it may lack one or two of the perfections that theorists dream of, but it weighs more and can be kept longer than a politician’s pledge. ❁

## Instead of ‘Integration’

December 5, 1949

Two years ago our government made the mistake of supposing that it could buy European recovery merely by pouring dollars into Europe and not even insisting in return on the minimum reforms needed to make recovery possible. Slowly, by the pressure of events, our ECA officials have themselves come to realize that lasting European recovery can come only from the efforts of Europe itself. They know we cannot continue to

give new blood transfusions forever. The chronic European hemorrhage is brought about by the policies of European governments. It will stop only when those policies are abandoned.

As evidence that our government finally recognizes this, the speech of Paul G. Hoffman before the Council of Economic Cooperation on Oct. 31 was encouraging. But from asking too little, he now seems to be asking too much. Instead of insisting on the practicable, he seems to be demanding the utopian.

No less than sixteen times in his address he called for the economic "integration" of Western Europe. But precisely what does "integration" mean? Hoffman left this vague—so vague that European officials can interpret it as meaning much or little. He implied, however, that it was very far-reaching. He set up the "single market of 150,000,000 consumers" in the United States as the model to be duplicated for the 270,000,000 consumers of Western Europe. A "single market" of this kind implies nothing less than the political federation or unification of Europe.

It is not surprising that European statesmen look on this proposal with serious misgivings. What would our own feelings be if we were suddenly asked to "integrate" our economy with those of Canada and Mexico—or with those of Western Europe?

The danger of the Hoffman proposal is that in asking for the visionary we will not even get the possible.

To halt its present trade deficit and cure its general economic sickness, it is not necessary for Europe to adopt an "integration" of a type and degree that it never knew before in its history, even when it was most stable and prosperous. It need merely return to the economic policies that it practiced as a matter of course through most of the nineteenth century and adhered to in large part even through the '30s.

I would begin to sound utopian myself if I were to suggest that Europe think now of going back to the international gold standard. The European record of recent years does not make such a course easy. But it is important to remember that when each European country made it the central object of its monetary policy to keep on the gold standard at the parity it had previously adopted, there was necessarily that "coordination of domestic financial policies" that Paul Hoffman now calls for. No country could stay on the gold standard if it embarked on an independent policy of inflation. As long as each country's own currency unit was kept convertible into a fixed weight of gold, it was necessarily freely convertible also, at a fixed rate, into all other gold currencies.

The international gold standard was the greatest adventure in economic "integration" that the world has ever seen. Combined with free trade or even with moderate tariffs, it turned the world in effect into a single market.

It may be too much to expect a return to gold immediately. But it is not too much for American taxpayers to expect, in return for the dollars they are daily being forced to pour into Europe, insistence by our ECA officials on at least three minimum reforms: balanced budgets, the end of artificial cheap-money policies, and the abolition of exchange control. The first two reforms would halt the inflation that is undoing all our sacrifices for European stability. The third would allow a reasonable flow of trade, end the dollar shortage, and halt the trend to totalitarianism.

But it would be inconsistent and ridiculous for us to demand even these reforms as long as we ourselves are heading for a deficit of more than \$5,000,000,000 and persisting in a recklessly inflationary cheap-money policy. ☸

## In Praise of Paper

December 12, 1949

The recent speech of Allan Sproul, president of the Federal Reserve Bank of New York, before the American Bankers Association, was a startling revelation of official doctrine. It has already provoked some excellent answers—notably those of Joseph Stagg Lawrence in the Empire Trust letter and of Prof. Walter E. Spahr in *The Commercial and Financial Chronicle* of Nov. 10. I have space to make only a few random points.

"I perceive," said Sproul, "no moral problem involved in this question of gold convertibility." Let's help him to perceive one. Prior to the year 1933 our government pledged itself to pay interest and principal on its bonds in gold of a specified weight and fineness. It also pledged the holder of every currency note that it would redeem that note on demand in gold of a specified weight and fineness. It violated its most solemn pledge. It deprived the rightful owners of their gold. And it made the possession of gold by anybody but the thief illegal.

And now we are all being slapped on the back and told how lucky we are at last to have a system at home of irredeemable paper. Sproul sings paeans in praise of paper. "We use a paper money," he says, "which has the supreme attribute of general acceptability." He neglects to add—at a constantly falling value. The purchasing power of a paper dollar, according to the Department



of Commerce, is now only 52 cents, as measured by wholesale prices, in terms of the 1935–39 dollar.

Sproul resorts to flag waving. “The integrity of our money does not depend on domestic gold convertibility. It depends upon the great productive power of the American economy. . . .” Those who recall the disastrous paper-money inflations of history must shiver at this argument. Listen to Andrew D. White’s report of speeches made in the French Assembly in 1791 to defend the paper *assignats*: “‘Fear nothing; your currency reposes upon a sound mortgage.’ Then followed a glorification of the patriotism of the French people, which, he asserted, would carry the nation through all its difficulties.”

The nub of Sproul’s defense of our internal irredeemability is that the bureaucrats must be trusted implicitly but that the people cannot be trusted at all. It appears that when you allow the people to redeem their money in gold they always want to do it at the wrong time—i.e., just when it is most embarrassing for the government to meet the demand; in other words, just when the government has connived in an inflationary expansion and issued more paper claims than it is able to honor.

“The principal argument for restoring the circulation of gold coin,” Sproul declares, “seems to be distrust of the money managers and of the fiscal policies of government.” He couldn’t have said it better. What he fails to see is that this mistrust has been richly earned. In addition to the shabby record of Sir Stafford Cripps, we need to remind ourselves that some 30 governments instantly followed the British example. They wiped out overnight, by simple ukase, part of the value of every paper currency unit in the hands of their own people.

Yet in the face of this almost universal record of currency debasement (not to bring up our own sorry record of currency inflation since 1933), Sproul can seriously speak of leaving everything to what he calls “competent and responsible men.” Said Sir Stafford Cripps, in explaining his devaluation record: “Even if we had then had some future intention of altering the rate of exchange, which in fact we had not, no responsible minister could possibly have done otherwise than deny such intention.” Here, then, is an authoritative definition. A “competent and responsible” monetary manager is one who not only lies to his people regarding the future of their currency but even considers it his *duty* to deceive them.

Sproul’s currency theory may be summed up thus: Put your faith in the monetary managers, who have always fooled you in the past. ❁

## The Compensatory Budget

December 19, 1949

A few weeks ago fourteen academic economists, several of whom might be expected to know better, came out in favor of “counter-cyclical fiscal action”—i.e., “surpluses in good times and deficits in bad.” I was forced to pass this by at the time because a worldwide monetary earthquake fell in the same week. But the admirable analysis of the “compensatory budget” theory in the December letter of the National City Bank provides a fresh occasion to take it up.

“Annual budget balancing,” declare the fourteen economists, “is both difficult in practice and unsound in principle.” That it is difficult in practice all history attests. So is any other virtue or worth-while goal. But “maintenance of the national credit by a Federal budget annually balanced” (to quote the pledge of the Democratic platform on which Franklin D. Roosevelt ran in 1932) is an incomparably sounder principle than the foggy alternative offered by the fourteen.

Even they put in a patronizing word for the annually balanced budget. “One great merit it does have: it provides a yardstick. . . . Every government program undertaken has to be paid for in a clear and unequivocal sense . . . This is a principle every citizen can understand.”

And dropping that principle has led and will lead in practice only to fiscal irresponsibility, inflationism, and eventual disaster.

An annually balanced budget has one enormous advantage. Everyone knows exactly how long a year is. Everyone knows on what day it begins and on what day it will end. But nobody knows how long a boom or depression is going to last while we are in it. Even hindsight can’t answer this question exactly. How do we know how far we are above or below normal unless we know what “normal” is? How do we know on just what day even a past depression stopped? Each set of statistics yields a different answer. Which set do we go by? How dependable are the statistics themselves?

The fourteen want to throw away the only real yardstick we have. The decision whether to plan for a surplus or a deficit, and exactly how big a deficit, would then be determined by somebody’s guess about the economic future. “We can, however, reasonably expect that the budget be formulated in the light of economic judgment available.” *Whose* judgment? Leon Keyserling’s, say? And suppose the economic forecasts of the Administration prove as bad in the future as in the past? Well, better luck next time.



The compensatory-budget theory subordinates or disregards the maladjustments in costs and prices that may be causing stagnation. It especially ignores the relationship of unemployment to excessive wage rates. It assumes that booms or depressions are the purely mechanical result of the volume of money available for spending. It overlooks what Albert Hahn has called the “compensating reactions to compensatory spending”—the chief of which is the destruction of business confidence.

But even if it had none of these economic weaknesses, the political consequences of the “compensatory” budget are alone decisive against it. The budget is to be balanced only when conditions are “normal,” and overbalanced only when they are positively booming. At such times the politicians are to increase taxes and reduce expenditures to bring the boom to a halt. This reversal would be politically unpopular and perhaps politically fatal.

Even at the height of an inflationary boom, therefore, the party in power could never be brought to admit that the boom was quite high enough to be halted. We have seen an example of this even within the last twelve months. So even in a year when we count our national income at the second dizziest height it has reached, we face a probable budget deficit of \$5,000,000,000 to \$8,000,000,000.

The compensatory-spending philosophers merely put into the hands of the inflationists and spendthrift politicians a theory that they can and will use to their own ends. ❀

## Voices for Freedom

December 26, 1949

Some weeks ago the Norwegian weekly *Farmand* carried an editorial called “Why So Timid?” “One of the phenomena of the postwar period in Norway,” it declared, “is that business has shown no will to defend its interests against the encroachments of the government. . . . Norwegian businessmen with lamblike meekness and patience have let themselves be tricked, abused, and stepped upon. . . . It is up to the individuals to take the trouble of finding out whether Norwegian citizens still have protection under the courts and the Constitution.”

With a few changes in its illustrations, this editorial would apply with striking aptness here. Timidity

before the encroachments of government power has, in fact, become worldwide.

We need not go into all the reasons here. One is the bribes to immediate self-interest, (jobs, benefit payments, defense contracts) that a government is able to offer particular groups or persons. Another is the dominance of a statist ideology. But most important of all is the fear of government retaliation. This is the chief cause of the paradox that the greater the tyranny of a government, the less complaint there is against it. In Russia today there is no internal complaint at all, but only frantic competition in flattery. We may lay it down as a political principle that the more power a government has already been permitted to seize, the easier it is for it to seize still further power. Businessmen and public-relations advisers rationalize their timidity in the phrase: “Don’t stick your neck out!”

All the more honor, therefore, to those writers and businessmen who do have the courage to stick their necks out. That is why it was gratifying to read, a few weeks ago, of the presentation of awards by the Freedoms Foundation at Valley Forge to writers and business firms who “spoke up for freedom” in 1949.

Two of the recipients are particularly well known to readers of *Newsweek*. One is my colleague, Raymond Moley, who received an award for his admirable column on “The Coils of Bureaucracy” (Dec. 13, 1948). The other is Warner & Swasey of Cleveland, whose advertisements in these pages over a period of years in defense of our free-enterprise system have been distinguished for their rare grasp of the virtues of that system and for the compact clarity with which they state those virtues. I wish I had space to refer to other award winners no less deserving.

Unfortunately, however, the majority of business firms seem to be under the illusion that they can sit back and enjoy a free ride while a small courageous minority bears virtually the full burden and expense of defending the private-enterprise system upon which the ultimate prosperity, independence, and existence of every private business firm depends. If this minority, however able, proves too small for the task, the rest will have no one to blame but themselves.

The awards of the Freedoms Foundation are wide-ranging. They cover editorials, magazine articles, radio programs, motion pictures, comic strips, speeches, sermons, and advertising campaigns. But for some strange reason they do not cover books, which usually have the longest life and influence of all. Let us hope that the Freedoms Foundation will add this category.

If it had existed this year, there would have been some outstanding candidates for awards. I have already reviewed on this page *Human Action*, by Ludwig von Mises (*Newsweek*, Sept. 19). I should like to add here *Economics and the Public Welfare*, by the late Benjamin M. Anderson, which is not only the outstanding financial and economic history of the United States for the

period from 1913 to the present, but one of the most powerful expositions of the free-market economy and of the distortions caused by shortsighted government interventions. . . . But now there is space only to add the names of John T. Flynn's *The Road Ahead*, Felix Morley's *The Power in the People*, and F.A. Harper's *Liberty*. ❁



1950





## If Foreign Exchanges Were Freed

January 9, 1950

Even those responsible for the devaluation of some 30 currencies since September admit that the results have been disappointing.

Devaluation was, in fact, the wrong remedy. What was called for was not continued exchange control with lower fiat rates, but the restoration of free exchanges. This is a necessary transitional step to eventual return to a full international gold standard. Gold means real stability based on freedom. Exchange control means a fictitious stability based on coercion.

Exchange control subordinates the citizen to the bureaucrat. Free exchange rates subordinate the bureaucrat to the citizen. Under controls the bureaucrat imposes a fiat rate by telling the citizens: "You must buy and sell sterling (or dollars) at this rate or else." With free rates the bureaucrat is compelled to woo the confidence of the citizen. He must follow policies that will make the citizens of his own and other countries place a high value on the currency and real faith in its stability. Hence freedom promotes fiscal and monetary reform, while exchange control conceals the necessity for it.

Sir Stafford Cripps must bear the chief blame for the fateful decision to devalue, and for the chain reaction that it touched off elsewhere. But responsibility must be shared also by the International Monetary Fund.

The last annual report of the fund was available to Cripps two months before he announced devaluation on Sept. 18. If the report had recommended free exchange rates he would have been forced to give the recommendation great weight. But it never did. It did strongly hint at the need of "an exchange rate adjustment" for "countries with dollar payments difficulties." It was this hint that Cripps followed.

The fund report wavers between a philosophy of freedom and a philosophy of statism. It deplores, in the abstract, "restrictions and discrimination" and "multiple rates." It dreads the prospect of world trade "conducted with inconvertible currencies on the basis of bilateral bargains." But when the fund faces a specific decision, it usually throws its weight on the side of control. Never once has it unequivocally come out for the abandonment of exchange control. It prefers fiat rates to free rates.

When Peru in November adopted a free rate for its currency, and took one of the most promising steps away from exchange control that has been taken by any nation since the war, the fund gave the action a very

cool approval. And the November review of Barclay's Bank of London explains that "to allow sterling to go free would have been against the letter and the spirit of the Bretton Woods agreement"—under which the fund was established.

In the same report in which the fund deplores "restrictions" we find it urging its member nations to place still further restrictions on private transactions in gold—either at "premium prices" or for "illegitimate purposes, particularly hoarding." Today nearly every government in the world is inflating and debasing its currency unit, cheating its own citizens of their savings. The fund gives its apparent blessing to this process: "Changes in exchange rates can, and under appropriate conditions should, be an instrument of economic policy." The real villain, it seems, is not the government that prints and depreciates paper money, but the citizen who tries to protect himself against this depreciation by putting part of his savings in gold.

Yet the fund, in the face of its own record, seems genuinely surprised that the world has not been moving toward freedom. "No member of the fund," it finds, "which originally availed itself of the provisions permitting exchange restrictions in the transitional period, has subsequently felt itself able to renounce the rights provided." On the contrary: "In a number of countries, new exchange restrictions have been imposed or existing restrictions expanded." ❁

## The Future of Foreign Aid

January 16, 1950

The Marshall Plan was based on a wrong diagnosis of the sickness of Europe and a wrong conception of its cure. Its sponsors now hail it as a great success. They attribute to it every economic and political improvement in Europe since it was put into effect. Every setback or deterioration, they explain, has been in spite of the Marshall Plan.

This one-way *post-hoc-ergo-propter-hoc* logic does not seem to be shared by the beneficiaries. In a recent poll conducted for the ECA in Europe, for example, only four Frenchmen in every 100 questioned thought the Marshall Plan had been a factor in French recovery.

On purely economic grounds, it would do no harm to terminate ERP when the present appropriation expires on June 30. Unfortunately, though there was not the slightest good reason for our doing so, we made an implied promise to the European governments that we would continue our Marshall aid for at least four years.

We would only bring on recriminations and charges of bad faith if we were to terminate it now.

On the other hand, even the ECA now talks of terminating aid in 1952 and of cutting next year's appropriations by 25 percent below that for the current year. But if ERP is to run for only two years more, the logical way to taper off would be to cut the appropriation by one third now and by a second third for the following year. The appropriation for the current fiscal year was \$3,778,000,000. This should be cut to, say, \$2,520,000,000 for the 1951 fiscal year and to \$1,260,000,000 for 1952.

To cut the appropriation by only 25 percent now would either imply at least a three years' continuance or require European governments to make a disproportionate adjustment at the end of the second year. It seems more reasonable to reduce Marshall aid by \$1,260,000,000 in each of the next three years than to cut it by only \$944,000,000 in the first (and second?) year and by the remaining \$1,890,000,000 in the third.

In tapering off Marshall aid in this simple, proportionate way, Congress should act as soon as possible—long before the end of the current fiscal year. And it should authorize now the appropriation *both* for 1951 and 1952. This would give European governments plenty of advance notice concerning how much they could expect to receive from us. It would enable them to make their plans accordingly. It would also forestall what would otherwise be constant propaganda for larger and continuing aid. The truth is that the amount set for ERP aid has always been an entirely arbitrary figure. To recognize this frankly would lead to enormous administrative simplification. Congress could simply direct that the reduced total sums it appropriated should be divided among the individual governments in the same ratio as in the current year. This would take from ECA officials a burden of decision that should never have been placed upon them.

In fact, the whole ECA bureaucracy was unnecessary from the first. The elaborate ritual of "counterpart funds" and other such special earmarked accounts is meaningless as a real control. It merely befuddles both Europeans and ourselves. All Congress need do is to authorize the Secretary of the Treasury to pay checks at regular intervals to the ambassadors of the recipient European governments. The ineffective but much-resented interferences of the ECA in the economic policies of these governments would halt. These governments would still have as strong an incentive to reform as any ECA pressure provides. It would be the definite knowledge that the aid was coming to an end.

Such a plan would be far superior to the proposed new "clearing union" for Europe. This "union" would be merely one more futile effort to do what the existing International Monetary Fund is already supposed to do. It would actually apply "incentives in reverse" by giving the most to the countries that succeeded in getting themselves the biggest trade deficits.

If we cannot have sound foreign-aid plans we can at least have simple ones. ❀

## The Forgotten Taxpayer

January 23, 1950

"This financial program," insisted President Truman in presenting his annual budget, "provides a sound basis on which to proceed." He thought his spending policy one of "prudence and restraint." "It provides for essential activities," he said, "on a minimum basis and no more." He spoke of it as if it were an abstemious, almost a niggardly budget. He had denied "request after request for additional funds." In fact, he declared at one point: "The major question in my mind is not whether we are doing too much [spending] but . . . too little."

This budget that Mr. Truman considers to be so sound, prudent, restrained, a minimum and perhaps too little, happens to be in simple fact a continuation of the largest peacetime expenditure ever proposed by the head of this or any other government in the history of the world.

The requested 1951 expenditures of \$42,440,000,000 would be greater than our total estimated national income in 1932. They would be more than five times the annual rate of spending in the peacetime years of the Roosevelt Administrations. They would be more than ten times the annual rate of spending in the Hoover Administration.

This colossal rate of spending, Mr. Truman argues, is necessary to meet the "demands which the foreign and domestic situations put upon" the people. It contributes "to the welfare of our people." It "encourages prosperity." It "maintains high employment." It promotes an "expanding economy."

The real truth is the exact opposite. Mr. Truman's bouquet of fallacies stems from looking solely at what the expenditures do or appear to do for those to whom they are given. He forgets that a government cannot give anything to Paul without taking it from Peter. In brief, he completely forgets the American taxpayer.

Mr. Truman really does assume that we can eat our cake and have it too. He forgets that the government cannot fill a single “need” without making it impossible for the individual taxpayers to satisfy other needs. He declares that “many Federal expenditures constitute direct supports for important sectors of our economy.” But he forgets that the taxes taken to make these expenditures must constitute at least equal direct depressants on other important sectors of our economy. He sincerely believes that he can pass economic miracles by seizing more and more from the American taxpayer and handing it over to someone else.

Yet you do not help the people to meet their needs by taking away from them the earnings on which they depend to meet those needs. You do not maintain high employment by putting further tax burdens on the industries that provide employment. You do not encourage production by burdening the productive to subsidize the unproductive. You do not create an expanding economy by killing incentives and draining industry of the very capital by which productivity is increased and an economy expanded.

Even with the present unparalleled burden of peacetime taxes the government stands to raise only \$37,300,000,000 in revenues. This means that it plans a deficit in the 1951 fiscal year of more than \$5,000,000,000. This deficit alone would be greater than the entire expenditures of the Federal government in any year in the Hoover Administration. It would come on top of an estimated deficit of \$5,500,000,000 in the current fiscal year, on top of eighteen deficits in the twenty preceding fiscal years, and on top of a national debt of about \$259,000,000,000.

What is most ominous is that the President no longer seems to consider deficits anything to worry about. He expects the country to be satisfied with the vague assurance that we are “moving toward budgetary balance in the next few years.” Mr. Truman and his advisers seem to believe that they can keep a perpetual boom going by perpetual deficit financing and perpetual inflation. And that belief, as experience shows, has always ended in disillusion and disaster. ❀

## Free Trade or State Domination?

January 30, 1950

In the winter of 1944–45, when we were still fighting Germany and Japan, and before the international fund or bank or the United Nations had become realities, I

wrote a piece with the above title in the pages of *The American Scholar*. It took a dim view of the brave new postwar world then being proposed by the bureaucrats.

“The demand now,” I wrote, “is for International Cooperation. But when the concrete proposals for this international cooperation are examined, it turns out to be something radically different from the international cooperation hoped for by the older liberals. It is not the freedom of the private citizens of any country to trade with the private citizens of any other. It is not primarily the cooperation among private citizens of different countries at all. It is primarily cooperation among governments.”

I went on to express misgivings concerning the way in which this might work out. In analyzing the proposed setup of the International Monetary Fund, for example, I voiced the fear that it might encourage inflationary money policies followed by a wave of devaluations—“the modern euphemism for debasement of the coinage.”

I wish I could report that my misgivings proved to be entirely groundless, and that the devaluations since last September of some 30 national currencies did not in fact occur. But they did.

I confess, however, that I did not foresee the full flowering of international bureaucratism. I did not foresee the innumerable sub agencies of the coming United Nations, with their thousands of bureaucrats daily flooding the world with propaganda in favor of still more bureaucratic controls. I did not foresee, for example, the nightmarish project just proposed by “a group of five outstanding economists” at the request of the United Nations Economic and Social Council.

But I can perhaps provide a useful guide to the reader through the current international bureaucratic maze. He will find that the thousands of international-control schemes resolve themselves, on analysis, into one or more of just three basic schemes:

Scheme One: To seize still more from the American taxpayer and turn it over to foreign bureaucrats.

The Marshall Plan, arms aid, and Point Four are mere beginnings. Thus one of the five economists warns that the United States “must be prepared to abandon the practice of doing too little.” We have, for example, handed out only some \$28,000,000,000 to foreigners since June 1945. Do we expect to save the world with chickenfeed?

Scheme Two: Each government is to keep constantly inflating, constantly shooting more paper purchasing power into the economy and constantly debasing its monetary unit. No matter what peak of



inflation it reaches, it is never to permit any decline below that peak.

The recent recession in the United States, for example, is regarded by the five economists as an "ominous signal." All sorts of irresponsible gadgets are proposed by the same economists to keep pumping in this paper purchasing power in "emergencies." Of course, for the record, lip service is also paid to means of curbing excessive inflation, apparently with the calm assurance that no government that values its tenure of office will ever adopt them. The same governments that are to inflate for constant "full employment" are also to help "prevent any continuous upward pressure for wage increases."

Scheme Three: Don't permit things to be bought or sold for their real market values, but only for the fiat values put on them by the bureaucrats. (Price fixing, wage fixing, profit control, exchange control, etc.)

My conclusion of 1944 still stands: "If the planners succeed in tying up the idea of international cooperation with the idea of increased State domination and control over economic life . . . the plain man's living standards will decline with his liberties." ❁

## Our Irresponsible Budget

February 6, 1950

Whatever may be thought of the President's tax message to Congress as a 1950 campaign document, there is only one possible judgment of it as a statement of fiscal policy. It is irresponsible.

In his budget message, for peacetime, for a year expected to record one of the three highest national incomes of our history, Mr. Truman *planned* a deficit of \$5,100,000,000. He now joins the popular clamor for reducing excise taxes. He asks Congress to impose compensating taxes, most of which would be even more harmful than the taxes he asks it to reduce. In order to "reduce taxes which burden consumption" he proposes to increase taxes which burden production. But even if all his proposals were carried out, and if the resulting yields came up to his expectations, he would still be recommending a deficit of more than \$4,000,000,000.

If there is any fiscal responsibility in Congress itself, its course is clear. It should return his proposed 1951 budget to Mr. Truman without approval, and request him to submit a responsible, balanced budget, with provision for a minimum debt reduction of \$600,000,000.

If it agrees that it is desirable to cut excise taxes by, say, \$700,000,000, and to allow not less than

\$600,000,000 for debt reduction, and if it agrees that other taxes are already at if not far beyond the highest levels that our economy can tolerate, Congress should become even more explicit. It should point out to the President that his present proposed expenditures of \$42,440,000,000 for 1951 must be slashed by a minimum of \$6,440,000,000 to make a responsible, balanced budget possible. The total expenditures under such a responsible budget, in other words, could not exceed \$36,000,000,000.

A responsible Congress would further inform the President that he ought not to place upon it the impossible burden of trying to find where all the wastes, inefficiencies, and non-essential items in his budget are; and that if he wishes to avoid what he calls "foolish budget slashes" it is his job to make the cuts himself. Congress should tell the President, in other words, that he will have to learn to get along on a mere \$36,000,000,000 in the next fiscal year, even if this is only four or five times the rate at which the Roosevelt Administration spent in peacetime and nine times the rate of spending under the Hoover Administration.

A responsible Congress would go on to demand executive responsibility. The proposals in the President's tax message are extremely vague. Congress should insist that the Administration spell these out in detail; tell exactly what excise rates it wants on what; exactly what new corporate rates it wants; and exactly what new provisions for oil and mine depletion. Congress should ask the Administration, in brief, to draft and submit the complete text of its proposed tax-law changes. Congress is under no obligation to adopt these Administration proposals; but Congress and the country should insist on knowing precisely what they are. That is the only way to get executive responsibility.

Mr. Truman's tax message is honeycombed with contradictions. He persists in declaring, for instance, that the deficit of more than \$4,000,000,000 which he plans for the fiscal year 1951 "will be due largely to the shortsighted tax reduction enacted by the 80th Congress." If Mr. Truman really believes what he says, his only consistent course is to recommend immediate restoration of the higher tax rates prevailing before the cut. He actually declares, on the contrary, that "nothing could be more foolhardy than to attempt to bring about a balanced budget in 1951" by "drastic increases in tax rates" or "drastic cuts in essential expenditures." So he denounces the 80th Congress for bringing about a deficit that he insists upon maintaining.

The country is in grave financial peril unless the Administration can be brought to end this political double talk and recognize its responsibilities. ❁

## Take out the Goat

February 13, 1950

A poor peasant, according to an old folk tale, went to the Wise Man of his village for help and advice. The peasant lived in a one-room mud hut with his wife and four children. He was driven to desperation by the noise, the quarreling, the smell, the dirt, the poor scanty food, the poverty, sickness, and squalor in which his family lived.

"I will help you," said the Wise Man. So the next day he brought a male goat to the peasant's hut, saying; "You must feed this goat and take him in and let him sleep in the hut." "Why, O Wise Man?" asked the peasant. "You will see," replied the Wise Man. "Come back to me at the turn of the moon.

On the night of the new moon the peasant was back. "O Wise Man, my life is unendurable. The noise in the hut is hideous. The smell is beyond belief. The goat knocks down the children and eats us out of hut and home. I am sunk in wretchedness and despair."

"I will help you," said the Wise Man. And he came and took away the goat.

A week later the peasant came to him again, his face wreathed in smiles. "O Wise Man," he said, "my life now is wonderful. You cannot imagine the change since you took away the goat! The hut is quieter. The horrible smell is gone. My family has once more almost enough to eat. How can I ever thank you enough for taking away that goat? How infinitely wise you must be to have thought of such a marvelous plan!"

I keep thinking of this tale as I read about the new plans of the bureaucrats all over the world. They impose an endless network of restrictions, burdens, coercions, and prohibitions on their own peoples; they all but strangle production and trade. And then their most happy solutions consist in removing one or two of the burdens and prohibitions that they themselves have decreed.

The cleverest new scheme of the ERP bureaucrats in Europe, for example, is to remove 60 percent of the import quotas that they themselves imposed. Last September the bureaucrats of some 30 nations hit upon another wonderful scheme. Instead of forcing people to buy and sell currencies at rates ridiculously above their real market values, and so damming up the flow of international trade, the bureaucrats now force people to buy and sell these currencies at rates much nearer to their real market values. Perhaps an even more brilliant stroke would be to remove all import quotas and allow people to buy and sell currencies freely at whatever rates they could mutually agree upon.

The bureaucrats rightly recognize that there can be no free flow in international trade until currencies are made convertible. To achieve this they now propose complicated "clearing unions" which would provide jobs for still more bureaucrats. They put forward other schemes of wondrous ingenuity. But it hasn't seemed to occur to a single bureaucrat that the only reason currencies are not now freely convertible into each other is that the bureaucrats themselves are *forbidding* holders of currencies to buy and sell them freely at market rates. Perhaps the idea of repealing this prohibition will eventually occur to some supergenius.

A few weeks ago the British Labour bureaucrats suddenly increased bacon and candy rations. Though this merely relaxed their own restrictions, the British bureaucrats did this with the air of philanthropists conferring a charity. The step was hailed as still another victory for Planning.

The most brilliant schemes of the planners today consist in tapering off their previous plans.

Even at home our politicians now talk of removing excise taxes. They too are going to confer a great favor by taking out a few of the goats they have forced upon us.

As the demand today is for constructive proposals, this department humbly submits its own. Stop putting needless burdens and coercions on people, production, and trade.

Let the bureaucrats take away their own goats. ☼

## Fifty Billions for Tribute?

February 20, 1950

Sen. Brien McMahon's proposal that our government contribute \$50,000,000,000 over five years for a "global Marshall Plan" is the culmination, the *reductio ad absurdum*, of the befuddlement on foreign economic policy in which Washington has wandered for the last five years.

Senator McMahon's proposal is, to put it baldly, a proposal to pay unparalleled tribute. No other word fits. "Tribute" is defined in the dictionary as "a stated sum . . . paid by one sovereign or state to another in acknowledgment of submission or as the price of peace, security, protection, or the like."

When we were small and considered weak, our minister Charles Pinckney, on being told by Talleyrand that a gift to the Directory might avert war with France, made his famous reply: "Millions for defense, sir, but not one cent for tribute." Yet today Senator McMahon, at a time when we are by far the strongest nation in the world, proposes that we pay up to \$50,000,000,000 as

the price of Stalin's promise to stop threatening us with atomic or hydrogen bombs.

This mere proposal, by the chairman of the Joint Committee on Atomic Energy, is certain to be taken by the leaders behind the Iron Curtain as a sign of fear and weakness. The leaders of the Iron Curtain countries have already found that they can with impunity plant spies in our midst, blockade us at Berlin, beat or imprison our envoys, and insult and vilify us every day. What further move may they not be encouraged to take by this timorous offer of ransom? Even Secretary Acheson's emphatic rejection cannot fully offset this blow to our prestige.

The McMahon proposal obviously lacks sense. Would we make ourselves safer by pouring billions of our dollars into Russia, by reducing our economic and military strength to increase hers, by intensifying the problems of our free-enterprise system to mitigate the problems of her Communist system? And if for four years Stalin has unswervingly refused to call off the atomic-bomb race, even when we were far ahead of him, and even at the risk of the annihilation of millions of Russians and of his own regime, does it make sense to suppose that he will reverse his stand now for a mere monetary bribe?

It is time we asked ourselves frankly, in fact, whether an atom-bomb "agreement" might not actually be more dangerous than the present known lack of agreement, by binding us and not the leaders of Russia. These are the same leaders who have broken promise after promise, who believe that the end justifies any means, who live by systematic perfidy. The proposals for international "inspection" of the vast depths of a totalitarian Russia are not realistic. Even if our inspectors finally did catch up with a plant in Russia that had been working on the bomb—after we had poured in our \$50,000,000,000 to help finance it—what recourse then?

But the real point of this article is economic. Senator McMahon himself calls his proposal a "*global Marshall plan*" and casually drops Point Four inside it. It is a supergiveaway program. It is not only politically preposterous, but it rests on the same fundamentally false economic assumptions as the Marshall plan and Point Four. It wrongly assumes that the American capital thrown into such schemes is a net addition to the world's capital. It is in fact a mere diversion of such capital. And it is a diversion, in the main, from productive private enterprises into far less productive collectivist projects.

Such schemes do not encourage private lending abroad; they discourage such lending. They do not speed up recovery and development of world resources; they retard that recovery and development. For as long

as foreign countries can get easy money, seized from our taxpayers, out of the United States Government, they will neither give the assurances nor make the economic reforms that they would *have* to make to attract private investment.

It is time we called a halt to the giveaway mania. ❁

## Future of the Marshall Plan

February 27, 1950

Congress has unwisely committed itself to two more years of the Marshall plan. Because of this, I suggested in this column of Jan. 16 that the simplest way to taper off the plan would be to cut the amount by one-third next year and by a second third for the following year. The simplest way to do this, in turn, would be to abolish the ECA bureaucracy, to divide the sums among individual governments in the same ratios as in the current year, to present the money as a gift, attach no conditions to it, authorize now the appropriations for both years, but put these governments on notice that our aid will definitely terminate at the end of this two-year period.

This plan is the simplest we could adopt. It is least likely to be misunderstood. Politically it would give no ground whatever for the criticism that we were trying to interfere in the "internal" affairs of the governments concerned. Let us call it Plan A.

But Congress may quite properly want to insist on economic and financial reforms in Europe in exchange for our aid. In that case the best plan would still be to abolish the ECA bureaucracy and to turn our aid program over to the Export-Import Bank. The bank should be authorized to make loans guaranteed by European governments that conformed to half a dozen simple but mandatory requirements of eligibility unequivocally laid down by Congress. For example:

1—No loan should be made directly to any government, but only to some specific productive enterprise, private or governmental. Each loan must be fully guaranteed, however, by the government of the borrowing country.

2—If the loan is to a going enterprise, private or governmental, that enterprise must be currently operating at a profit.

3—If the loan is made to start any new enterprise, that enterprise must be private. Native investors must supply equity capital equal to not less than a third of the total capital.

4—The guaranteeing government must itself be operating on a balanced or overbalanced budget.



5—The borrowing country's volume of money and bank credit must at least not be growing faster than its physical volume of production.

6—The borrowing country must at all times maintain free convertibility of its currency, if not by going on a gold or dollar basis, then at least by permitting free exchange rates.

Let us call this Plan B. It may be objected that few European governments would be willing to make the reforms necessary to qualify for such loans. But as long as governments do not make these reforms, our aid to them is misdirected and wasted anyway. If at the end of six months any governments had not availed themselves of the loanable funds allotted to them, these funds could be made available instead, in the already established ratios, to governments that did conform with the eligibility requirements.

Plan A and Plan B could not of course be in effect simultaneously. But Congress could if it wished put Plan A into effect for, say, six months or a year to give European governments plenty of time to adopt the reforms necessary to make themselves eligible as guarantors for loans from the United States under Plan B.

Finally I should like to suggest Plan C. This is not a third alternative; it could be combined with either A or B. Under Plan C we would offer to forgive our entire loan of \$3,750,000,000 to the British Government in lieu of further advances to that government under ERP. As these advances do not promise to be more than about \$1,250,000,000, in the next two years in any case, the British Government should be greatly tempted to avail itself of such a choice. It would be relieved of \$3,750,000,000 in indebtedness, and it would improve its net position by some \$2,250,000,000. From our standpoint, it would save us about \$1,250,000,000 in further cash advances. And it would remove what will be otherwise a source of resentment and recriminations between Britain and America for many years. This is precisely the opposite of the original purpose of the loan. ⚙

## The Needless Crisis in Coal

March 6, 1950

By the time this article appears, the legal and economic outcome of the coal strike may be fully known. But the confused ideas and laws which brought on this crisis will condition the terms on which it is settled, and the precedents set may even decide the very nature of our future economy.

The immediate cause of the crisis was President Truman's failure to invoke the injunctive provisions of the Taft-Hartley Act until too late. There was not a shred of excuse for this irretrievable loss of time. The Taft-Hartley Act provides: "Whenever in the opinion of the President . . . a *threatened* or actual strike or lockout affecting an entire industry or a substantial part thereof . . . will, *if permitted to occur* or to continue, imperil the national health or safety, he may . . . direct the Attorney General to petition any district court" etc. (My italics.) The threatened emergency was obvious to everybody else weeks and even months before Mr. Truman got around to admitting its existence. By the time he did, our national economic life was already in such peril that John L. Lewis could dictate almost any terms he pleased.

But the causes of the coal crisis go much farther back than Mr. Truman's procrastination. The Taft-Hartley Act, notwithstanding its injunctive provisions and all the nonsensical charges about its being a "slave labor" law, merely continues the basic provisions of the Wagner Act with a few minor amendments. Like the Wagner Act, it turns the government itself into a union-organizing agency. It legally compels employers to negotiate with a Petrillo or a Murray or a Lewis no matter how unreasonable his demands. It sanctions and builds up industrywide unions. It encourages strikes by taking nearly all the risks out of them. It practically deprives the employer of the right to declare that the strikers have quit their jobs and to offer permanent employment to others to take their place.

Our one-sided laws are in turn the result of a confused ideology which believes that unions can do no wrong and that they can be granted sweeping legal immunities without danger of abuse, including immunity from the antimonopoly laws. The unions are granted a sweeping "right to strike" which is interpreted to include not merely the acknowledged right to the individual to quit his job but the spurious right forcibly to prevent anybody else from taking the job that he has deserted.

Under cover of protecting these spurious "rights" of the unionneers everybody else's rights are abridged. The railroads were deprived of their right to run coalburning trains and the public of its right to travel on such trains—even when there was still officially no emergency at all. The states and cities suspend the right of private ownership and use of coal, the right to supply or get current or the right to turn on electric lights. And all to protect the precious right of John L. Lewis to paralyze the economic life of the country until he can dictate the terms on which he will refrain from doing so.



The government continued to force the operators to negotiate with Mr. Lewis as the spokesman for the miners after those miners defied his public orders to return to work—which meant that, if his orders were given in good faith, he was no longer their spokesman. Because the government made itself impotent even to enforce its own injunction, it was proposed to seize the mines. Instead of punishing the strikers, it was proposed once more to punish the struck-against. Such action is not only unnecessary and irrelevant, but it erodes the concept of private property and brings us nearer to nationalization by default. Meanwhile miners' union goon squads are permitted to roam the country and to resort to mass picketing, intimidation, or violence to prevent anybody else from mining coal.

Yet no one proposes to reexamine first principles; no one proposes to enforce the common law against violence, vandalism, and intimidation, and no one proposes simply to repeal the Taft-Hartley Act, period. ❁

## The American Giveaway Mania

March 13, 1950

The Administration is now possessed with a mania for “lending” or giving away the American taxpayer's money to any foreign government that it can coax into taking it. This mania grows by what it feeds on. The Marshall plan is only one channel for it. In addition there are the Export-Import Bank, the International Bank, the International Fund, the arms aid program, and the proposed global catchall. Point Four. Our foreign policy can almost be summed up in four words: “Give ‘em more money!”

If none of these government handouts had been devised, Europeans would still have had great need for American capital. They would have had to apply for private loans. And they could have got these only by restoring the confidence of American private investors. It is not difficult to specify the reforms they would have had to make to inspire such confidence:

1—They would have had to assure anybody who put money into Europe that he could get it out again. This means that they would have had to make their own currencies freely convertible into dollars. They could have done this simply by dismantling their wartime exchange control.

2—They would have had to assure foreigners holding pounds, francs, or lire that these currencies would not depreciate. This means that they would have had to halt monetary inflation. To do this they would have had to return to balanced budgets.

3—To return to balanced budgets European governments would have had to give up nationalization, which has meant huge deficits in the nationalized industries. They would have had to reduce to manageable dimensions food subsidies and overgrown relief and “social security” programs.

4—They would have had to stop threatening still further nationalization, expropriation, and seizure.

5—They would have had to relax or abandon controls over wages, prices, interest rates, and profits.

6—They would have had to reduce excessive taxation.

If Europe had been obliged to attract private capital, such reforms would already have gone far farther than they have. They would have brought not only far more production, but the freer and more balanced trade, the “currency convertibility,” the “multilateralism,” and the “integration” for which our ECA officials have made futile exhortations. The reason for their futility is clear. As long as foreign governments can pick up easy money from our own government they don't have to make these reforms.

As a result European recovery has not only been slow and precarious, but the recovery that has taken place has been in the wrong direction. Production indexes have gone up; but the added production is not primarily for export, as it should be, but for home consumption. So foreign trade is still unbalanced, and Europe's self-induced “dollar shortage” remains.

The dilemma of the Marshall plan and of Point Four, the dilemma of every government-to-government handout, is plain. If our government imposes no conditions on its handout, the money is worse than wasted. If it does impose conditions, they provoke foreign resentment.

Our ECA officials vacillate between the horns of this dilemma. First they say that they won't interfere in the “internal” affairs of these countries. Then, of course, the European governments getting our aid make in return none of the economic reforms so desperately needed. The British bureaucrats repay us by discriminating against American motion pictures and American oil companies. The French repay us by threatening the sale of Coca-Cola. Then our ECA officials talk of “getting tough.” But when it comes to a showdown they cannot risk insisting on reforms that would be really effective. So we end by subsidizing foreign-government discrimination against our own industries.

In short, government “loan” and gift programs like the Marshall plan and Point Four do not promote world recovery; they retard it. We are subsidizing and

prolonging statism and socialism abroad, and imperiling our own free-enterprise system to do it. ❁

## Where Do We Go from Here?

March 20, 1950

Having himself helped to deliver it one staggering blow after another over the last five years, President Truman is now curious to know why the nation's coal industry is sick.

Even if the kind of commission of inquiry he asks for, mainly appointed by himself, could be nonpolitical and objective, it is not needed. For the essential facts about the coal industry are already known. These facts are that John L. Lewis, aided by Congress and the President, has won too many Pyrrhic victories. As a result, coal labor costs are too high, coal is overpriced, the supply is never dependable, and coal is losing out everywhere to the competition of oil, natural gas, and water. In 1947 coal supplied 50 percent of the nation's energy; last year its contribution was down to 38.5 percent. Of 1,142 new railroad locomotives on order, only twelve will be powered by steam.

It is not the coal industry that needs to be investigated but the President's own incredible labor policy.

Mr. Truman has repeatedly demanded the repeal of the Taft-Hartley Law, called it "unworkable," denounced it as a "slave labor act," and otherwise encouraged Mr. Lewis and other labor leaders to flout it. He failed to act under the injunction provisions of the law until weeks and even months after he should have acted. Then a Federal judge held that though the miners continued to strike after the injunction, they were not in contempt because, don't you see, they were merely acting "as individuals." This made the injunction meaningless and the government impotent. And nobody in the government even drew the logical conclusion that if Mr. Lewis could not get his own back-to-work order respected he should no longer be dealt with as the miners' spokesman.

So, because of the crisis that Mr. Truman himself helped to bring about, he asked Congress for power to seize the mines. Having made the government impotent to deal with the strikers, he threatened to crack down on the struck-against. This seizure threat forced the prompt surrender of the mine operators. If it hadn't, Congress would no doubt have given Mr. Truman his requested legislation.

Yet the legal situation that such a law would create would be fantastic. Thanks to present law Mr. Lewis is dictator of the nation's coal industry. It is considered an infringement of his sacred constitutional rights even to

prevent him from ordering three-day weeks to deprive the nation of coal. But under Mr. Truman's seizure law property rights could be abridged every time Mr. Lewis chose to create a crisis. Then the government could step in and dictate wages and profits while it ran the mines. Though this would abridge rights, there is no assurance that it would end strikes. For miners could still refuse to work "as individuals."

Mr. Truman seems to have forgotten entirely that even when he seized the railroads in May of 1946 he did not end the strike that had been declared against the generous wage decision of his own fact-finding board. On that occasion Mr. Truman was finally reduced to proposing that he be given the totalitarian power to throw the strikers into the Army and force them to run the trains that way.

Mr. Truman's labor policy was already bankrupt in 1946, and he has learned absolutely nothing from his experience since then.

The power of industry wide unions was never so menacing as now. The simplest solution would be to repeal the Wagner-Taft-Hartley Act, lock, stock and barrel, and so restore free, two-sided wage bargaining.

If this solution is deemed at the moment politically impossible, then the second best course is to remove the sweeping immunities of the labor unions from the antimonopoly laws, and above all to stop compelling individual employers to deal with industry wide unions. If nationwide unions continue to be imposed on industry by law, they will in time make it impossible for our private-enterprise system to function. This is the alternative that confronts us. ❁

## That European Payments Union

March 27, 1950

If Congress wants to save the American taxpayer \$600,000,000 it could find no better way of doing it than to reject the ECA proposal that we pour that amount into a "European Payments Union."

This proposed "Payments union" would merely seek to do for Western Europe, and by the same methods, precisely what the International Monetary Fund already seeks to do on a global scale. Assuming that this scheme ought to be carried out at all, why not utilize the already existing IMF to do it? Why not at least place the proposed regional organization inside the existing global fund? Why set up an entirely new, competing, overlapping, and duplicating institution?

But the questions to be raised about this scheme go much deeper than organizational ones. What is proposed is that \$600,000,000 more of the American taxpayer's dollars be thrown into a huge kitty, together with fresh and practically automatic loans of the European governments to each other.

The purpose of this is to enable these European countries to buy more goods from each other. There is no reason to suppose that the scheme wouldn't, at least temporarily, achieve this result. Anybody can buy more goods if somebody else gives him the money to do it with.

But at what cost, and at whose expense, will this be done? It is argued that if the European countries are encouraged to buy more from each other they will need to buy less from the United States and the rest of the "dollar area," and so "save dollars." But by the same reasoning (unless they have unemployed resources), if they sell more to each other they will have less left over to sell to the dollar area—and certainly less incentive to sell it. In other words, they will have less incentive to earn dollars.

There are strong reasons for thinking, in fact, that the tendency of the proposed European payments union would be to turn Western Europe and the sterling bloc into one big soft-currency area—and to reduce the trade between this soft-currency area and the rest of the world. For this intra-European trade would be financed by a new dose of easy dollars and inflationary credit. This inflationary credit would tend to raise price levels still further within the area, increase its price incentive for dollar imports, and reduce still further its ability to export competitively into the dollar area. Moreover, though the member nations promise to cut down their quantitative restrictions on imports from *each other*, the scheme contemplates that they would continue to discriminate against the outside world, and even be encouraged to do so to "save dollars."

In short, the scheme threatens not only to turn Western Europe into a big walled-in soft-currency area, but actually to increase on net balance the dollar deficit of that area. It would tend to delay rather than promote worldwide multilateral trade. It would tend to delay rather than accelerate general currency convertibility, and above all the convertibility of sterling and European currencies into dollars.

The greatest single step toward a free and balanced international trade would be to restore the general convertibility of currencies into each other. This can be done only by the abolition of exchange control. The traders of every country must be allowed once more to

buy and sell their own or other currencies at whatever rates are established in free markets.

To prevent currency depreciation and violent fluctuations governments must stop resorting to police methods. They must turn to the restoration of confidence. This will require a halt to inflationary policies and to threats of more socialism and expropriation. Ultimately it will require a return to the international gold standard. For Britain it will require to begin with the blocking or funding of the old overhanging sterling debt. But in general what is needed to promote world recovery and restore world trade is not still more bureaucratic tinkering, but the restoration of economic freedom. ☼

## Rent Control Forever?

April 3, 1950

Every year since the end of the war the Administration has asked for the extension of rent control "just for one year more." There is no reason, as I hinted in this place last year (*Newsweek*, March 14, 1949), why this could not go on forever. For the Administration wants rent control extended "until the supply of housing has caught up with the demand." But "supply" and "demand" are meaningless except in relation to a price. It is rent control itself that keeps supply from catching up with demand. It perpetuates the very problem it pretends to solve.

Rents are out of line with all the rest of the price structure. Weekly factory wages are now 151 percent above the 1935–39 level. Rents are up only 23 percent. The cost of living is 67 percent higher than in 1935–39. Clothing is 85 percent higher; food prices 96 percent higher. Less than 13 percent of wage earners' spending went for housing in 1949, compared with more than 18 percent in 1935–39. Since 1939, the cost of building has increased between 100 and 140 percent.

Statistics do not indicate a real overall housing shortage. The Census Bureau found that there were both fewer persons per occupied dwelling unit and more rooms per unit in 1947 than in 1940. But rent control itself has brought about the *appearance* of a housing shortage. For it encourages tenants already in possession to use space wastefully at low rents. And it intensifies the problem for people unlucky enough to be caught without a roof, forcing them to bid high for the little space open to them.

The best solution is to let Federal rent control lapse on June 30. This, no doubt, has drawbacks. In some states and cities it would bring tenants back to economic reality with a sudden jolt. In other states and cities the



local politicians are already taking over rent control on the purely demagogic principle that tenants have more votes than landlords, and are entitled to occupy their present quarters at prewar rents indefinitely—no matter how much their own incomes have gone up in the last ten years or so.

One possible political compromise, if there should be any extension of Federal rent control, would be to permit landlords in the next three years to raise rents by no more than 15 percent a year, and to provide for automatic decontrol thereafter.

One might playfully imagine another compromise, which might provide a more rapid economic education than any other. Prohibit the landlord from raising any rent whatever on his own initiative, but when a lease expires allow him like an auctioneer to accept the highest bid. Then if Paul is occupying an apartment at \$50 a month, and John bids \$60, Thomas \$70, and Peter \$75, Paul will have to meet Peter's bid or surrender his apartment to Peter.

Under such an arrangement rents would come almost immediately into line—and into working relationship—with other prices and incomes. No one could denounce the landlord for asking an unreasonable or outrageous rent. He would not be asking any rent at all, but merely accepting what he was offered. Politicians could no longer picture the situation as a class struggle between landlords and tenants. It would be recognized as essentially the competition of tenants with each other.

Families on the outside would have as much right to bid for a new lease on an apartment as the particular family in it. What quarters you occupied, and at what rent, would no longer be determined by past individual luck or accident but by present conditions. Living quarters, like food and clothing, would once more be rationed by the purse. The economic principle would once more be emphasized that under competition prices are not determined by the greed or arbitrary whim of sellers but by the competitive bidding of buyers. Above all, rents would go to the level where they would give the maximum balanced stimulation to private building, remodeling, and repairs, thereby increasing the quantity and improving the quality of housing for the greatest number of families. ❀

## How We Subsidize Collectivism

April 10, 1950

The action of the House on continuance of ERP does not indicate that we are going to use any more common

sense in dealing with the European economic problem in the future than we have in the past.

The Administration has dismissed all critical discussion of the Marshall plan as "partisan" and "isolationist." It attempted to drive the new ERP bill through Congress under a barrage of emotional slogans and scare words. Though we originally offered Marshall aid to Communist Russia itself, it is now represented as our chief weapon for "combating" Communism. Once more it is implied, by the President, that refusal to vote for the Administration bill may bring on the third world war. "Failure to enact *its full amount*," he writes, "would do irreparable damage."

Properly resenting these tactics, but without leadership of their own, a bipartisan majority in the House did have the temerity to cut the authorization by the moderate amount of \$250,000,000. They also cut the authorization for Point Four by \$20,000,000. But they failed to recognize that in accepting the premise of Point Four—that the American taxpayer owes the rest of the world a living—they were letting him in for a bottomless obligation.

If the Senate is interested in the kind of revision that is really needed in the ERP program it could not do better than to read the article by Dr. William Röpke in the *Commercial and Financial Chronicle* of March 16. Writing from his European watch tower in Geneva, Dr. Röpke says supremely well what some of us have also been trying to say over here for the last three years. The present economic troubles of the countries of Western Europe, he points out, spring mainly from the nationalistic policies being pursued within those countries:

"It is no longer necessary to define those national policies. They are familiar ever since Hitler came to power and, under the guidance of Dr. Schacht, set the example of a type of national economic policy which we propose to call National Collectivism. It is the well-known combination of repressed inflation, collectivist controls, 'full employment', exchange control, state monopolies, bilateralism, subsidies, fiscal socialism, 'cheap money' policies, and the strange mixture of the restriction of private consumption and of public waste which goes under the name of Austerity. . . .

"With the exception of Switzerland and Belgium, all European governments still practice National Collectivism to the extent that they feel compelled to retain exchange control. It is exchange control, which is the real keystone of National Collectivism. . . .

"The devaluations certainly eased the strain, and they were in most countries the indispensable condition for the removal of exchange control. . . . But the chance offered by the devaluations has not been used,



which means that the European governments resemble a surgeon who opens the abdomen without removing the inflamed appendix."

Dr. Röpke then turns to the proposed European Payments Union. "It is being realized by most observers that convertibility of currencies is the cardinal problem. To restore convertibility, however, is tantamount to abolishing exchange control. Not daring to face this thorny issue, many people prefer to believe that there is something 'almost just as good.' It is the idea of a European Clearing Union. . . .

"The crucial point, however, is again whether the national governments retain exchange control or not. If they do, then the idea of a European Currency Union has hardly more sense than an American currency system would have if the United States would split into forty-nine systems of state collectivism and of state exchange control. If they abolished exchange control, then we have all the monetary integration we need without the new cumbersome machinery of a European Monetary Union."

As a result of the evangelistic and intolerant fervor with which its sponsors promote the ERP over here, none of these economic realities is getting any serious attention. ❁

## Global Spending Forever?

April 17, 1950

The amendments made up by the Senate Foreign Relations Committee to the House-approved Point Four program are nearly all in the right direction. The real question is whether they go far enough.

Certainly the committee was wise in rejecting the House provision for United States Government guarantees of private investments abroad. Such guarantees mean that we would allow private investors to keep the profits of their investment but would force the American tax-payer to assume the losses. This would be intolerable.

Listen to Secretary Acheson's defense of this proposal: "Protection from some of the risks [to foreign investment] cannot be provided by treaty no matter how sincere the intentions of the participating governments. Therefore, a bill has been introduced [to guarantee and insure private investors] specifically against expropriation, confiscation and seizure, and against inability to convert local currencies."

In other words, because these foreign governments sincerely cannot prevent themselves from seizing

American property or forbidding currency conversion it is up to the American taxpayer to make good.

Chairman Connally of the Senate Foreign Relations Committee has expressed apprehensions that the initial \$45,000,000 sought for the Point Four program for the coming year would be only the start of a more ambitious and costly program. "As time goes on," he says, "I can feel the pressure coming in the window for big projects."

So the committee put a five-year limit on Point Four. But will this time limit prevent pressure for further extension five years hence? The ECA, remember, was to last only four years. Of course, Administrator Hoffman reassures us, "ECA aid should be terminated on its schedule date of June 30, 1952. . . . *But* even with ECA liquidated I doubt if expenditures for foreign aid can be held below \$2,000,000,000 annually. "ECA aid," in other words, will stop; but we are to continue global spending under some other name. "Point Four," perhaps? And after five years of Point Four, "Point Forever"?

It is of the first importance that Congress reject the *principle* of Point Four. Once we accept the implied premise of that program—that it is the duty of the American taxpayer to subsidize "underdeveloped areas" everywhere, i.e., that the American taxpayer owes the rest of the world a living—we let ourselves in for endless and bottomless responsibilities.

It is impossible in this space to unravel all the fallacies and misconceptions behind the Point Four program. I have myself written a 48-page pamphlet analyzing these in detail.\* Here I can merely list some main conclusions:

1—The fact that Point Four so strikingly parallels the proposals of the official head of the Communists in this country in 1944 is at least reason for careful scrutiny.

2—Point Four will not add to the total invested capital of the world. It will at best merely *divert* that capital from one channel to another—largely from private projects to government or socialistic projects.

3—We cannot give our cake away and eat it too. We can speed up the capital development of other countries only at the expense of our own capital development. We cannot get rich by giving our exports away.

4—The British peanut fiasco and our own Lustron-house loans illustrate in advance what typical Point Four projects would be like.

5—Even if a Point Four program were necessary, the International Bank for Reconstruction and Development and the Export-Import Bank already exist to do precisely what is proposed under Point Four, and are already doing it in ample prudent volume.

6—The assumptions that global government hand-outs or “loans” promote sound private international investment, accelerate a return to free enterprise, or speed up world recovery or world development, are the exact reverse of the truth.

*\*Illusions of Point Four.* Single copies on request from the Foundation for Economic Education, Irvington, N.Y. ❁

## How to Buy More Unemployment

April 24, 1950

In the first three months of this year, according to official estimates, there has been an average of nearly 4,500,000 unemployed.

This is paradoxical and premonitory. For this unemployment, the greatest since prewar days, exists not in a depression but in the midst of an inflationary boom. It exists, in fact, in a period when the Administration boasts that personal incomes have reached the highest levels in our history.

Yet this paradox is not inexplicable. It is simply what discerning economists predicted was certain to happen if we continued to push up wage rates and labor costs faster than prices and productivity. And we have kept boosting labor costs recklessly through union policy, pension demands, government “fact-finding” awards, the Wagner-Taft-Hartley Act, and the new law jumping minimum-wage hourly rates from 40 to 75 cents last January.

The presumptive effect of this last factor is striking. Unemployment averaged 3,395,000 throughout 1949 and stood at 3,489,000 in December. This January it shot up to 4,480,000.

Does the Administration recognize the cause of this unemployment? Has it taken warning? On the contrary, it does everything to intensify the problem. In a message to Congress on April 6, President Truman called for a further increase in unemployment benefits. For existing unemployment he offered two explanations, both wrong. He explained that more people have been coming into the labor market every year. But they have been doing that since the beginning of our history, with the annual increase in population. Increased population means not only more people looking for jobs; it also means more consumers and consumer demand.

Mr. Truman’s other explanation is that “as new plants and equipment have been added . . . businessmen have been able to produce more with the same number of workers.” This assumes the immemorial fallacy that machinery creates net unemployment. But as man-hour

productivity increases, prices go down or wages and profits go up, and per capita demand increases with per capita supply.

Because he makes the wrong diagnosis, Mr. Truman proposes the wrong remedy. We need not examine here the real revisions required in unemployment insurance. It is enough to point out that all Mr. Truman’s own arguments ignore the salient fact that as we increase the amounts and period of payment of unemployment benefits we encourage an increase in unemployment itself. The more we pay men who are idle, the more we reduce the penalties and increase the incentives for idleness. Mr. Truman wants to pay a man who has been earning \$60 a week as high as \$42 a week for not working. But if this man is offered another \$60 job before his unemployment benefits expire, he may logically ask himself: “Why should I work for only \$18 a week?” Or if he is offered a temporary \$42 job: “Why should I work for nothing?”

Our national labor policy is, in fact, the equivalent of the farm price support policy. Government support boosts the price of farm products so high that part of the supply must remain unsold. The taxpayer is then forced to hold the unsold surplus. Government and union labor policy, likewise, pushes up wage costs to the point where part of the labor force must remain unemployed. Then the taxpayer must pay unemployment benefits to this idle labor. “Surplus” labor rots in storage like “surplus” eggs, butter, and potatoes.

The present American situation—of high unemployment even at the peak of an inflationary boom—is not unprecedented. Precisely the same anomaly occurred in Germany in 1927, and for the same reasons.\*

In 1927 economists like Gustav Cassel warned in vain that the German wage policy was senseless. Will such warnings today, in America, prove equally futile?

\*See *The Economics of Illusion*. By L. Albert Hahn. Sequier Publishing Co., New York. Pages 238–241. ❁

## For a Responsible Budget

May 1, 1949

The British Labor government is spending \$3,248,000,000 a year on social services and food subsidies and only \$2,186,000,000 on defense. Yet instead of reducing these “welfare” handouts to leave more to spend on armaments, the British bureaucrats think it is up to the American taxpayer to make good Britain’s defense deficiency. Other European bureaucrats think likewise. What they spend on collectivist experiments is none of our business. Our business is merely to make

good the shortage this creates in other directions. Ours not to ask the whys, ours but to subsidize.

In fact, instead of continuing to discuss what is wrong about the British budget, it would be just as well if we drew a moral for ourselves from the one thing that is right about it. It is balanced. For the fiscal year ended March 31 it shows a surplus of \$1,537,000,000. For the new year which began April 1 it plans a surplus of \$1,240,000,000.

Contrast with this the officially estimated deficit in our own budget of \$5,400,000,000 for the current fiscal year and \$6,200,000,000 for the coming fiscal year. Congress's own staff of fiscal experts thinks these will be closer to \$6,700,000,000 and \$7,300,000,000 respectively.

In all fairness we must not overlook the ironic fact that our own current deficits can be mainly accounted for by ERP and arms aid to Europe, and that the British surpluses can also be largely accounted for by this same ERP and arms aid. Still, it remains remarkable that hard-pressed socialist Britain shows a balanced budget, while rich "capitalist" America, at the peak of its biggest boom, cannot bring its expenditures within its revenues.

The basic explanation is simple. Britain has a responsible budget system. And we have not.

In Britain the executive branch is made completely responsible for the budget. Both sides of it. The Chancellor of the Exchequer not only submits all his proposed expenditures in detail but submits at the same time the detailed taxes and tax rates by which he proposes to raise the revenues.

Parliament cannot tinker with this budget. It cannot increase an expenditure here or reduce a tax there. It must accept or reject the budget as a unified whole. And upon its ability to submit a budget acceptable to Parliament the government stands or falls. Compared with this, our so-called American budget is meaningless make-believe. The President submits his guesses of what expenditures and revenues are going to be. This is not accompanied by any overall tax bill, or by any bill at all. Congress neither accepts nor rejects this "budget." The President may later propose still more expenditures as an afterthought. Congress may vote still more expenditures on its own initiative or reduce some unpopular tax regardless of the effect in throwing the budget further out of balance. The President and Congress then blame each other, and both deny responsibility.

We shall never approach the fiscal responsibility of the British system until Congress submits a self-denying Constitutional amendment to deprive itself of the power to vote any expenditure not recommended by the President. It must of course retain the power

to reduce proposed expenditures. Stripped, like the British Parliament, of the power to raise, it might at last exercise its power to cut. As Henry Jones Ford pointed out: "There is no propensity of human nature more marked than jealousy of opportunities that one does not share."

Congress can never be expected properly to exercise the vital function of guardian of the people's purse as long as it is permitted to stick its own hands in that purse. If the President did not fear to be outbid by Congress, he would propose smaller spending in the first place. But as long as three branches of government—President, House, and Senate—are all free to compete with each other in offering handouts to pressure groups with the taxpayer's money, the taxpayer's prospects are not bright. Somewhere there must be a restraining hand. And it is most likely to act as such when it has no other power than the power to restrain. ❁

## How to Tell a Totalitarian

May 8, 1949

The danger of authoritarianism in this country is increased by the persistent failure of our self-styled liberals to recognize its real source. The leading article in *The New York Times Magazine* of April 23—"Portrait of the Authoritarian Man," by Samuel H. Flowerman—typifies this state of affairs.

Flowerman tells us that "social scientists. interviewed and tested more than 2,000 persons" and found a "ready-made 'authoritarian personality'." Did they? Pseudo-science notwithstanding, there is no such thing as a typical "authoritarian man" but only an authoritarian ideology. It is the difference in ideology, and not in persons, that basically explains the contrast in political climate between 1950 and, say, 1910.

Flowerman implies that the totalitarian ideology is dominantly conservative. Error. It is dominantly radical. Soviet Russia—the greatest totalitarian power today—ought to be sufficient illustration. True, the Communists once explained Nazism as the last desperate stand of "capitalist conservatism." But it is impossible to swallow this explanation of a movement that proudly called itself *National Socialism* and was vehemently anti-banker, anti-gold, anti-creditor, anti-"plutocrat," and anti-capitalistic in its tirades and decrees.

Flowerman declares that the "opposite" of the "authoritarian personality" is the "extremely democratic personality." Confusion. The true opposite of the authoritarian is the libertarian. A self-styled "democracy," or



“people’s government,” like Soviet Russia, that repudiates the principles of liberty is a phony democracy.

Flowerman implies that racial bigotry is an invariable and central characteristic of the authoritarian mind. Again Soviet Russia shows that this is not necessarily so. Totalitarianism, it is true, always needs scapegoats—but not necessarily racial scapegoats. They may be “Jews,” kulaks, “wreckers,” “American spies,” “profiteers,” speculators, employers.

Flowerman thinks it an “offset” to authoritarianism that “Americans traditionally scoff at authority.” Does he mean that we should admire the people who pass red lights, spit in the subway, and rob their neighbors? Those who fail to respect law within its proper bounds do not insure real liberty but imperil it.

“Certainly research findings indicate,” writes Flowerman, “that so far the key to the difference between the authoritarian and democratic personalities lies in the relationship between parents and children. Learning to disagree with one’s parents may be the capstone of a democratic personality.” Some of us had previously supposed that one should learn to seek and believe the truth, even if one’s parents also believed it. The real difference between the authoritarian and his opposite, the traditional liberal or libertarian, is this. The authoritarian has no faith in the people, and unlimited faith in the bureaucrats. The libertarian distrusts excessive power in the bureaucrats, because he has a real faith in the people. That is why he believes that the fundamental liberal institution is the free market. The free market means free voluntary relations between buyer and seller, worker and employer. It means free prices, free wages, free production, free trade. To the authoritarian such freedom means chaos. He distrusts any economic arrangement that is not planned from the center and from the top. He must fix prices, wages, profits, rents, allocate raw materials and labor. He cannot believe that international trade will balance unless he intervenes to balance it. He must control foreign exchanges, restrict travel, license or prohibit imports.

Once embarked upon this “social engineering,” he must keep widening the circle of his prohibitions and coercions until he has wiped out all economic liberty and all other liberty with it. His intolerance of liberty must grow because any liberty whatever will imperil his plan.

It is in this ideology—statist, collectivist, socialist—that the real menace of totalitarianism lies, rather than in children who agree with their parents. ❁

## Self-Perpetuating Rent Control

May 15, 1950

President Truman has made his annual plea to Congress to extend rent control for just “another year.” But if his arguments are sound we should logically prolong rent control indefinitely. “Until supply is near enough to demand,” he says, “so that the forces of competition will again operate effectively to protect the tenant, rent control should continue.” This puts the cart before the horse. If the forces of competition were really allowed to operate they would bring rents to a level where supply and demand would balance.

“Supply” and “demand” are meaningless terms except in relation to a price. It is precisely the function of price to bring supply and demand into balance. As long as rents are held arbitrarily below the level to which competitive bidding among renters would bring them, there must be a “shortage” of housing. Rent control perpetuates the very problem it pretends to solve.

It is the strange paradox of rent control that the very dislocations it brings about are triumphantly cited as arguments for its prolongation. “A sudden and simultaneous removal of rent controls,” the President tells Congress, “would precipitate a wave of exorbitant rent increases.” (He nowhere says what he thinks an unexorbitant, or reasonable, increase would be.) “Such increases,” he continues, “would seriously reduce the purchasing power of millions of families.” They would also, of course, increase the purchasing power of other families by an exactly equal amount. This correlative fact he never mentions.

Suppose, for a moment, that clothing prices, instead of rents, had been held down until now to 23 percent above the prewar (1935–39) level, instead of being permitted to rise in a competitive market, as they have, to 85 percent above. If anyone were then to propose that such clothing price control now be ended, it would doubtless be argued in reply that this was premature, because (1) a serious clothing shortage still existed (as under such imagined stiff price control it certainly would), and (2) that if controls on clothing prices were suddenly and simultaneously removed, it would precipitate a wave of price increases averaging perhaps 50 percent, which would seriously reduce the purchasing power of millions of families. The argument could be made with even more force if similar controls had arbitrarily held down food prices.

A control of any sector of the economy, in short, becomes an argument for its own perpetuation. When we turn to a *generally* controlled economy, hardly anyone has the courage to argue for freedom in any one



sector because of the obvious dislocations this would bring with the controlled sectors. This is strikingly illustrated in an analysis of British rent control by F.W. Paish in the April issue of *Lloyds Bank Review*. Professor Paish finds the British Rent Restriction Acts a “lawyer’s nightmare.” They create inequities between tenant and tenant, tenant and landlord, and above all “between those who are lucky enough to have rent-restricted houses and those who have no houses at all.” They impair the landlords’ ability and incentive to maintain premises in good condition: “Much property is being allowed to degenerate into slums.” They erect grave impediments to the mobility of labor. But as a “solution” to all this, Professor Paish puts forward a scheme more complicated and desperate than rent control itself.

Let us not judge him uncharitably. What man dare suggest isolated freedom of rents in an economy whose other main sectors, including foreign trade, food, and wages, are still under controls? It is impossible to have an economy half-slave and half-free.

The best solution to our own problem is to let Federal rent controls lapse now. If there must be another political compromise, let it be one that at least makes a real start toward nationwide decontrol. It might permit landlords to raise rents by a maximum, say, of 15 percent a year for the next three years, and then expire automatically. “Rent control,” says John H. Williams, “may benefit tenants in the short run, but in the long run it merely reduces the amount of housing.” ❁

## The Giveaway Mania Grows

May 22, 1950

Both houses of Congress have not only voted to continue the ERP program for another year, but in addition—the Senate by the narrow margin of a single vote—to underwrite the indefinite commitment of Point Four. This raises the global giveaway program to a new dimension. In the starry eyes of its proponents there is no discernible limit to this program. When it was first proposed to give billions to Europe, a few tried to point out that most of the arguments for the proposal—such as curing an alleged “dollar famine,” boosting foreign living standards, “combating” Communism, or buying peace—could be just as well used as pretexts for throwing billions of the American taxpayers’ funds all around the world. ERP proponents eventually conceded the logic of this corollary. But instead of reexamining their

European policy, they merely demanded its worldwide expansion under the name of Point Four.

The majority in Congress now seems seriously to believe that the real issue is whether the first-year authorization for Point Four should be \$25,000,000, as voted by the House, or \$45,000,000 as voted by the Senate. This point is, of course, of negligible importance. It is as if the buyer of a \$500 television set were to raise a fuss about making a down payment of 45 cents instead of a quarter, when the real object of the seller is to get his name on the contract. The television buyer, at least, is getting definite value for his money, and he knows that there is a definite limit to what he will have to pay. But the taxpayers who will be forced to finance Point Four all over the world know neither what it is that they are buying nor what it will eventually cost them. As the global giveaway expands, the arguments for it become constantly vaguer and more rhetorical. Its advocates talk as if you could buy peace the way you buy potatoes. Isn’t it cheaper, they ask, to spend \$20,000,000,000 for peace than \$103,000,000,000 a year for another war? If anyone asks whether the global giveaway program in fact provides any assurance of peace, the usual answer is that of course it doesn’t, but isn’t it worth a calculated gamble? And if anyone goes on to ask whether this particular gamble has been or could in fact be calculated, or whether the whole program doesn’t simply divert attention from the bankruptcy of our talk-tough-but-act-soft, call-names-but-appease policy toward Russia, he is simply dismissed as an “isolationist.”

The economic arguments for ERP as at present set up, and still more for Point Four, cannot stand analysis. But when one points out, for example, that the so-called “dollar gap,” whether in Europe, India, or Argentina, is brought about solely by exchange control and is otherwise pure humbug, the argument, even if understood and accepted, is dismissed as unimportant. The real reasons for the Marshall plan and Point Four, one is told, are not economic but political.

But when we stop to scrutinize these alleged political reasons, we find them even less convincing than the alleged economic reasons. We are fighting socialism and collectivist controls in Europe by subsidizing their continuance (so that the head of Britain’s Board of Trade can now announce, for example, that Britain’s foreign-exchange control will be kept as a “permanent instrument”). We are fighting Communism by financing it in Yugoslavia. Mr. Truman proposes to fight Communism in China by sending food there—though this would directly or indirectly make more food and other supplies available to the Chinese Communist armies and to the

Soviet Union. And he proposes to fight Fascism in the Argentine by relieving the financial difficulties of Perón.

Those who are proposing to toss the American taxpayers' money so recklessly to foreign governments are of course in no position to recommend withholding anything from pressure groups or special interests at home. So foreign and domestic extravagance are turned into arguments for each other, and the spending mania grows by what it feeds on. ❀

## The Fairdeal Family at Home

May 29, 1950

George Fairdeal and his wife, Alice, are having breakfast.

*Alice:* But if we decide to buy the new house, dear, we'll have to give up that trip to Europe this summer.

*George:* Why? Why not do both?

*Alice:* But we've only got \$1,000 in the bank. If we use that to take title to the house, we won't have anything left for the trip!

*George:* You always worry about where the money's coming from. If we have to, we'll borrow it.

*Alice:* From your brother Bob again? We've been getting more deeply in debt to him every year!

*George:* Oh, don't talk like a Republican! Bob's one of the family. As I always say to him: "We just owe it to ourselves."

*Alice:* And how about the money for Jane's singing lessons?

*George:* Don't worry! My family's going to have everything! The best!

*Alice:* Now be sensible, dear. What's our income from the store?

*George:* About \$3,500 a year. And that's not bad. It's more than the income of most families in the country today. I was just reading—

*Alice:* I'm not complaining, dear. But if it's \$3,500 then we can't spend \$4,500. And if we spend our \$1,000 savings in Europe we just won't have it for a new house of our own. We can't get a quart out of a pint jug. That's all I'm trying to say.

*George:* Raise your sights, Alice! Dream big dreams and plan big plans! Our national income is running today at a rate of \$223,000,000,000 a year! Hot diggity! And ten years from now it's going to be \$350,000,000,000!

*Alice:* But we're running into *debt*, dear—*now*! Remember? Some day we'll have to pay Bob back. When are we going to start? And how about saving something? Suppose one of us gets sick? And what are

we going to live on in our old age?

*George:* This is the richest nation in the world. The government ought to pay our medical bills. The government ought to give us old-age pensions! They can afford it!

*Alice:* When you say the government ought to pay our medical bills, George, aren't you really saying that *other* families ought to pay our medical bills for us?

*George:* Oh, bosh! The government has plenty of money.

*Alice:* Where does it get it?

*George:* Eh—from taxes. And I'm willing to pay my share of increased taxes for socialized medicine!

*Alice:* But we're an average family. Suppose we have the average amount of sickness and pay the average tax? Then everybody else may be paying our medical bills but we've taken on everybody else's medical bills! We're no better off than when we started. And we can't save for our own old age because we have to pay out the money in taxes to provide for everybody else's old age. It's just silly to think that everybody can be supported at the expense of everybody else!

*George:* We gotta distribute things fairer. Equalize things!

*Alice:* Do you mean, dear, that everybody who earns more than we do should have the difference taken away from him? Wouldn't that reduce his incentive to earn? And if his money is spent on those who earn less than we do, won't the people who get the handouts also have less incentive to earn? So wouldn't practically everybody produce less? And wouldn't that leave less of everything to distribute?

*George:* Don't be an obstructionist, Alice! The government ought to spend more on hospitals—

*Alice:* But won't that leave less for education, for instance?

*George:* The country should spend more on both! We must have—

*Alice:* But won't that leave still less for food or housing or whatever else we're already spending money on? All you're saying, dear, is that every family should be forced through higher taxes to spend its money on the things you think it needs instead of on the things each family itself thinks it needs. The more they spend on one thing the less they have left to—

*George:* Oh, bicker, bicker. I'm still hungry, Alice. How about some of that coffee cake we had yesterday?

*Alice:* We ate it, dear.

*George:* (flabbergasted): We did? ❀

## Toward State-Managed Cartels?

June 5, 1950

The Schuman proposal for “pooling” the coal and steel production of France and Germany was followed by a chorus of unqualified praise and endorsement. Nothing in recent months has so clearly illustrated the present matter-of-fact acceptance of a statist and collectivist ideology. The few voices that asked whether this might not mean merely one more state-dominated cartel were hardly heard.

Let us examine the text of the proposal: “The French Government proposes that the entire French-German production of coal and steel be placed under a joint high authority. . . . A president will be chosen by the governments by common agreement; his decisions will be enforceable in France, Germany, and the other member countries. . . . The setting up of the high authority in no way prejudices the question of ownership. . . .”

Now decisions by a “joint high authority” presuppose (1) the nonexistence or cessation of free competition among the individual companies; (2) that major decisions on policy would be made not by the heads of the individual companies, but by a single head; and (3) that the industries as a whole would be directed in the same unified way as a monopoly or a typical international cartel.

The “high authority” who directed the industries would be politically appointed. Such a setup does pre-judge the question of ownership because under it the managerial authority that is the usual prerogative of ownership would be held by governments. The profits of the individual companies would necessarily be government-determined. The proposed setup would be, in short, another step toward government management and state socialism.

“The functions entrusted to the joint high authority will be . . . to modernize production and improve its quality. . . .” This implies that the “high authority” will decide what new machines will be installed in which producing units. In short, a politically appointed head will decide the amount, nature, and distribution of investment in the steel and coal industries. The text calls specifically for an overall “production and investment plan” and an overall “reconversion fund to facilitate the rationalization of production.”

The plan envisages “the institution of a mechanism for equalizing prices”—i.e., central price control rather than free competitive markets. Wages would also be “equalized”—i.e., state-controlled and dictated.

“The flow of coal and steel between member countries will be immediately exempted from all customs duties and may not be subject to freight differentials.” Standing by itself, this part of the proposal would merit the highest praise. But what does it mean as merely part of a new quota or allocation system or state-controlled monopoly under which, for example, the more efficient companies would not be permitted to expand production and markets at the expense of the inefficient, high-cost companies?

The plan brings out the ambiguity in the newly fashionable word “integration.” What is proposed is a cartelized state-dictated “integration” rather than the only kind of integration reconcilable with efficiency and freedom. Let governments remove the international trade barriers they have themselves set up. Permit producers to make and sell as much coal or steel as they can. Permit consumers to buy coal or steel or whatever they want wherever they can get the lowest price. Let the relative efficiency and profitability of individual enterprises, and the relative demands of consumers for products of every kind, determine how much capital is invested, where, and in what. It is the restoration of free markets and free trade that will do most to increase world production, raise living standards, and promote peace.

It is indeed encouraging that France, on its own initiative, has made a sweeping proposal for economic cooperation with Germany. But in the long run no step can be really constructive unless it moves in the direction of freedom. ❀

## Salvation through Spending

June 12, 1950

The Truman Administration is beyond comparison the biggest peacetime spender in our history. At the height of an inflationary boom it still flounders in deficits. Yet until a few weeks ago we were told that the spending was temporary, made unavoidable by the cold war. The deficit was “inadvertent,” or the fault of the Republicans.

In a speech on May 15, however, Leon H. Keyserling, the new chairman of the President’s Council of Economic Advisers, came out frankly in favor of spending for its own sake. Spending itself is so necessary, it seems, that “when the costs of the cold war can safely be reduced we should use some of that saving to expand the programs of resource development and human security.” In other words, instead of economizing or trying to reduce the burden of taxes, we should then increase other spending.



"In 1929," says Keyserling, "Federal expenditures represented only about 3 percent of the nation's total production of goods and services. But this did not produce a healthy economy. During the most recent three years Federal spending has averaged about 15 percent." And this spending has "lifted our total national product" and "restored faith in the American way of life."

This is economic nonsense. It takes the credit away from the inventors, investors, managers, and workers responsible for our economic growth and assigns it all to the bureaucrats. By itself, in fact, government spending does not add a single dollar to purchasing power. It merely changes the directions in which money is spent. When the Federal government was spending 3 percent of the nation's income, it took only 3 percent of it away from the nation's taxpayers. When it spends 15 percent of the national income, it must in the long run take 15 percent away from the taxpayers. The taxpayers have as much less to spend for goods and services as the bureaucrats have more.

"The test," continues Keyserling, in his speech of May 15, "of whether Federal spending is wise or unwise is this: Is it putting people and other resources to work for purposes which are more useful to our economy as a whole than the other purposes for which this same manpower and other resources would be used if the Federal spending did not occur?"

And Keyserling's own implied answer is that he and Mr. Truman know how to spend money more usefully and wisely than the people who actually earned it. If you permit the citizen to spend his own money on the things he himself wants, he will run the economy into the ditch. The way to save him is to take the money out of his irresponsible hands. Let the bureaucrats spend it to expand their pet "social" programs. They know what the taxpayer needs better than he does himself.

Government can increase monetary purchasing power, not by spending *per se*, but only by deficit financing and by printing money and expanding credit. In short, by inflation. And the Federal government is now inflating by every direct or indirect means: by increasing its deficit, forcing down interest rates, supporting government bonds, increasing government loans for farm price supports, for housing, for small business, for big business, for artificial exports, and by political loans to every "democratic" foreign government from Tito's Yugoslavia to Perón's Argentina.

Inflation is always politically popular in the early stages. It raises prices, increases profit margins, promotes "full employment," expands incomes, wages and profits in terms of dollars, and makes everyone feel richer. The present inflationary boom can doubtless be

kept going for a long time yet. But the bigger and longer such a boom, the bigger and more certain, other things equal, the eventual bust.

One of the chief ironies of the present situation is that the very people who have been most derisive about a "boom-bust economy" are the ones now most zealous in whipping up the present inflationary boom to ever new and dizzier peaks. ❁

## Drought Fighting in a Flood

June 19, 1950

In his talk on June 6 President Truman made it clear that he is still fighting the 1932 depression. And he is fighting it by inflation. In the midst of the 1950 flood his main efforts are devoted to combating the 1932 drought. The rains are falling; the rivers overflow their banks; there is grave doubt that the flood can be controlled. But of all these dangers Mr. Truman is oblivious. "Remember that 1932 drought," he says. And he orders his rainmakers to bring another monetary downpour.

Inflation works its apparent magic because it depreciates the value of the currency unit and hence raises prices. Rising prices usually mean higher profits. The prospect of these brings the feverish activity and "full employment" that are the boast of every inflating government.

Inflation can go on for a long time and to great lengths. We need not cite here the horrible modern examples of Germany, Greece, and China. But the French currency unit, for example, has depreciated to a hundredth of its 1914 value (which is as if the 1950 dollar had no more purchasing power than the 1914 cent), and the danger of further inflation in France is still not altogether past. In general, inflation will go as far as political forces push it. And inflation is still politically popular here.

Once a nation embarks upon a "full employment" policy through monetary inflation, it can only continue that course either by inflating at an accelerative rate, or by resorting, as Britain and nearly every country in Europe has resorted, to "repressed inflation" through government controls.

Today our government is resorting to monetary inflation to keep "full employment," and is encouraging at the same time the chief counterforce to full employment—higher wage rates. Inflation brings its activity and employment by pushing prices ahead of costs. But if wage rates are forced up faster than prices, then marginal profits, and hence activity and full employment,



are threatened. No matter how high prices are forced, if labor costs are forced up relatively still higher, they must bring unemployment.

From this standpoint, the new General Motors five-year labor contract is a disturbing sign. Whatever General Motors may be able to take on (as one of the strongest corporations in the world), our economy could not stand the general adoption of this settlement as a precedent. The pension provisions are a formidable boost to present labor costs. And no economy can guarantee in *advance* to pay every year a "productivity" wage increase of 4 cents an hour, because no one can be sure there will in fact be that much real increase in productivity. As for the cost-of-living escalator clause, I need merely quote Bresciani-Turroni's 1931 book on the German inflation: "The inflation proceeded with quickened pace especially . . . after the workers had obtained money wages which varied with the index number of the cost of living."

We seem about to witness a new race between prices and labor costs. The amount of employment or unemployment will depend on which phase gets started first, and when.

Commenting on my article (*Newsweek*, June 5) on the Schuman plan for a European coal and steel pool, an American economist of European background writes from Paris:

"The whole press here seems to have lost its head. One reads only the crudest sentimental nonsense. . . . Such a pool would certainly create a common interest between German and French industrialists. It would yield them huge profits, because it would not charge competitive prices but prices based on the highest costs. In case of war every country would again manage its own plants anyway.

"The truth is that the greatest cartel in the world is being created. The funniest thing about it is that it is happening under the noses of hundreds of Americans busy fighting such comparatively minor trusts as the I.G. . . . It seems that a 'bold'—and vague and sentimental—slogan works better in our world than logic." ❀

## Who Are the Isolationists?

June 26, 1950

The most encouraging world economic development in recent weeks is the news that real stabilization of the franc and the removal of exchange controls is being discussed in official French circles. The most discouraging is the foreign-policy manifesto of the British Labour Party. Together these developments symbolize the

present conflict between international liberalism and isolationist socialism.

Whether French officials have in mind going on a gold basis, or going merely on a dollar basis, has not yet been made clear. Either decision would involve the serious initial problem of choosing a tenable rate. A rate fixed in dollars rather than gold would make the French economy a tail to the American kite. And as long as our own political authorities display their present carelessness about maintaining the integrity of the dollar, the wisdom of such a French decision would be highly dubious.

But what is most encouraging is that French officials are discussing the abolition of exchange control. Even by itself this would be an enormous step forward. Only freely convertible currencies will make possible free multilateral trade. That is what economic internationalism means.

The British Labour Party pamphlet unintentionally reveals a truth that socialists have always ignored or denied—that socialism does not promote international integration, but disintegration. It is nationalistic, isolationist, autarchic—not by accident, but inherently. What is most important in the Labour Party pamphlet is not that it rejects the Schuman plan, but its reasons for doing so—the general philosophy it enunciates. The British Labourites could properly have rejected the plan on the ground that what it proposes is merely a gigantic cartel. They rejected the plan, in fact, not on the ground that it would set up a monopoly, but on the allegation that this monopoly would be private and not governmental. The real truth is that, pernicious as a private European coal and steel monopoly would be, an inter- or supra-governmental one—using not merely economic but political power to exclude outside competition—would be far more so.

The British Labour Party declares that it "fundamentally rejects" proposals for freeing European trade by the removal of "customs duties, exchange controls, and quotas. . . . The sudden dismantling of internal barriers to trade would in the short term cause serious dislocation, unemployment, and loss of production. . . . Whole branches of industry . . . would go bankrupt."

This is a tacit admission that these branches of industry could not stand competition and freedom of trade. It is a tacit admission that production in Europe under exchange controls, quotas, bilateralism, and other "internal" trade barriers is grossly uneconomic and wasteful. It is a tacit admission that national socialism and national planning are not reconcilable with

international freedom of trade, including free exchange markets and full currency convertibility.

All this throws a brilliant light on the application of the Marshall plan. President Truman on June 10 once more denounced the “isolationists,” whom he identified as those who express any misgivings about our foreign giveaway programs. Yet it is the ERP program itself that has not only been tolerating, but sanctioning and subsidizing the isolationist policies of its British and other European beneficiaries—their exchange controls, bilateral treaties, quota systems, import prohibitions, their direct governmental discriminations against American goods. Our ECA officials have echoed and subscribed to all the isolationist European nonsense about a so-called “dollar shortage”—which is brought about purely by exchange control itself—and about a so-called “dollar gap”—which exists precisely because there is an ERP to fill it.

Our present foreign policy might be described, in short, as one that sanctions and subsidizes the economic isolationism of every country but our own. Yet freedom of trade has no meaning unless it is two-sided. ❁

## Free Trade or Coercion?

July 3, 1950

Rather than reiterate my own reasons for questioning whether the Schuman coal and steel pool proposal is a real step toward free trade and economic integration (*Newsweek*, June 5), I quote from the excellent summing up of George Winder in *The London City Press* of June 9:

“What Mr. Schuman proposes is a substitute for free trade—an effort to obtain its advantages without conceding the freedom which is its essential condition. Free trade brings about the integration of trade by giving the individual freedom to buy and sell as he likes. Mr. Schuman is attempting to give us the advantages of free trade by denying freedom. He intends to impose integration by setting up an international body with power to dictate to national producers. . . .

“However disinterested are the aims of those who desire to bring about this unification, we can be sure that, if it is attained, it will be run for the benefit of iron, steel, and coal producers and their employees, and not for the benefit of the peoples of Europe as a whole. . . .

“The integration of the iron, steel, and coal industries would require that the less efficient units should close down, and the more efficient would expand their production. . . . Any politician, however, who imagines

that the British iron and steel worker, and the British coal miner, or their French and German counterparts, would allow units of the industry which provides their livelihood to be closed down by the fiat of an international body, has lost all sense of reality. . . .

“But the economic unity of Europe, by means of free trade, is within the bounds of attainment. . . .”

The British Labour Party pamphlet rejects the Schuman plan, not because it would involve coercion, but because it would not involve enough. “Any industries concerned in European planning,” it insists, “should be subject to government direction in their own country.” Government “must be able to decide the investment policies of the basic industries. . . . Nothing less than public ownership can ensure this fully. . . . If there is any threat of a recession in world trade, it is then vital to maintain and perhaps increase investment in these industries. But this is just the time when private capitalists, fearing for their profits, restrict production.”

In other words, it is precisely when events have proved that steel is already being produced in excess of demand that socialism would increase steel capacity—not because anybody wants to buy more steel, but to maintain “full employment and stability”!

The National Executive Committee of the British Labour Party, which composed this pamphlet, does not know that it is precisely relative prices, profits, and losses that in a free-market economy decide the balance of production among thousands of different commodities. If this free-market yardstick is thrown away, nothing remains but naked government coercion. It is then the politicians and bureaucrats who decide arbitrarily how much of each thing is to be produced.

But at least the socialist authors of this pamphlet have a candor missing in our crypto-socialists at home. They do not pretend to be for socialism and the free market at the same time. “Our population,” they write, “would not tolerate the flagrant injustices of a free-market economy in which workers live in squalor yet see the shops bulging with goods beyond their reach.” No doubt the free-market squalor they have in mind is in the United States, where average factory wages are still only \$57 a week, as compared with the magnificent average of \$20 a week in Socialist Britain. I wish the authors had explained in more detail, however, how industry keeps going here and in other squalid free-market economies by turning out goods that nobody can buy.

Just why our own government thinks it must continue to force American taxpayers to underwrite all these economic errors, and support and subsidize these

anti-recovery policies, is a question, as I have learned by sad experience, that it is futile to raise. ❁

## Planning for a 'War Economy'

July 10, 1950

Its dramatic collapse on the news of the Communist invasion of South Korea reflected the judgment of the stock market that a war today would have a drastically adverse effect on the prospect for profits. Though war means huge war contracts, it also means a huge increase in corporate taxation. But what caused the violent market break on June 26 was not merely fear of the inevitable consequences of war *per se*, but fear of the kind of economic policies which might be put into effect.

Modern war, aggressive or defensive, is necessarily a collective enterprise and must necessarily invoke compulsion. But the preservation of a certain irreducible minimum of the individual's economic liberty, together with the kind of economic deterrents and incentives that normally guide him, is necessary not merely for its own sake, but for maximum and most efficient war production.

It is precisely this that is forgotten by most of those who come forward with plans for rigid economic controls to be imposed immediately upon the outbreak of war. The files of the National Security Resources Board are presumably stuffed with proposals for ready-made legislation and plans to be handed to Congress and Federal agencies on M Day. And most of these plans are known to be based on the assumption that what will be necessary in case of war is a more or less completely regimented economy.

One of the favorite proposals of these war planners, for example, is an overall freeze of prices and wages as of the day before the outbreak of the war. The idea behind this (apart from control for its own sake) is "to prevent war profiteering." But it is hard to think of any economic measure that would more surely embarrass and slow down the transition to an effective war economy.

The relationship of prices to each other, and of prices to costs, is based on the constellation of supply and demand at any given moment. These are the prices and costs, wages and incomes, calculated to maximize and balance production in accordance with the relative demand for thousands of different commodities and services at that time. But relative war demand is radically different from relative peace demand. And there is no more certain way to slow up the transition to a war economy than to try to freeze for wartime the price relationships adapted to peacetime.

It is commonly thought that blanket price ceilings are necessary in war to prevent a *general* rise in prices. But the way to prevent this is through money and credit policy. Speaking broadly, there cannot be a general rise in prices in wartime unless there is a corresponding increase in the volume of money and credit. If no increase in the volume of money or credit were encouraged or permitted, the tendency would be for rises in the prices of "war" goods to be compensated by declines in the prices of "peace" goods. The price "level" would remain virtually the same.

It is the shift in *relative* prices that tends to produce the quickest transformation from a peace to a war economy. Producers are attracted by the higher prices and profits in the war goods to start producing them immediately, while they are driven out by losses from the production of "peace" goods. The higher prices of war goods, moreover, permit producers of them to offer higher wages to workers than those obtainable in peacetime production, and so facilitate the quickest shift of labor as well as management into war production.

If this sort of quick voluntary shift is prevented by blanket price and wage controls, then the government has to fall back upon an enormously complicated set of coercive orders. This compulsory bureaucratic system—which is almost certain to be influenced by political pressure-group considerations—can never be as effective as flexible free markets.

We should always do what we can to prevent wartime profiteering, but this must always be subordinated to the chief end, which is the most effective conduct of the war itself. ❁

## A Bad Tax Bill

July 17, 1950

For a period of either prosperity or depression, peace or war, the tax bill passed by a vote of 375 to 14 in the House and now before the Senate is on net balance a bad measure.

In the new fiscal year for which there is already an estimated deficit of \$5,133,000,000 (without allowing for added costs in Korea) the bill would cut excise taxes by about \$1,010,000,000. To compensate for this it would increase other taxes, chiefly on corporations, by about \$1,000,000,000. This means that in a period of peak prosperity and inflation the House voted a deficit of more than \$5,000,000,000.

Some of these excise taxes—notably those on railroad freight and passenger travel, and on telephone and telegraph messages—are without excuse in peace times.



But the way to make possible their removal was to cut Federal expenditures by a few billions, not to place still heavier burdens on other forms of production.

Some of the cuts in excise taxes are hard to understand, especially in view of the taxes substituted for them. There is a tax on radio sets and on movie admissions but not on television sets. There is a tax on croquet balls and mallets but not on fencing equipment. A tax is retained on all railroad freight including coal, but the tax on \$65 watches was removed because these are "necessities."

The House bill attempts to compensate for these excise cuts by soaking the corporations. The real purpose of the provision to speed up corporation tax payments is to make the current inexcusable Federal deficits look smaller; in the long run this device will not add a dollar to Federal revenues.

The House bill still treats corporations as if they were separate and additional individuals, instead of merely a way in which individuals organize for production. Corporate income taxation is double taxation. To tax corporate income 38 or 41 percent, and then tax dividends by individual income-tax rates, is to tax the same income twice. This puts a heavy penalty on corporate production and discourages investment in new corporate enterprises. It strikes directly at the job-creating organism. It retards increases in real wages.

It is estimated that an average of \$8,000 in capital is invested in every job in American industry today; it is precisely this capital that makes these American jobs as productive and remunerative as they are. The Ways and Means Committee's majority report argues that it increased corporate rates by only 2 or 3 percentage points. It refuses to face the ominous long-run implications for production of a 41 percent tax takeout of corporate earnings even before the investor is asked to pay individual income tax on the dividends he receives.

The committee majority, still treating corporations as if they were individuals, taxes corporate incomes at graduated rates and proudly points out that it has reduced taxes on "small" corporations earning less than \$167,000 a year and increased them only on corporations earning more. This means that a rich stockholder in a small corporation has his tax reduced while a small stockholder in a big corporation has his tax increased.

The Republican minority report, one must admit, says some excellent things: "Taxes are eating at the foundation of our free-enterprise system." The new bill shifts "the tax from some of the consumers to a more concealed tax on all of the consumers." "As a natural corollary to reduction of excise taxes there should be a drastic reduction in Federal expenditures."

How true! And if military expenditures must now be increased, then a slash in nonmilitary expenditures becomes more imperative than ever. But what of acts? When President Truman on June 23 courageously vetoed a discriminatory veterans' bonus disguised as a postal pay increase, two out of three Democrats in the House, and four out of five Republicans, voted for the added expenditure over his veto. "Federal expenditures must be immediately reduced," say the Republican committee members. Do you reduce by more political handouts? ☸

## The Inflation in Housing

July 24, 1950

The direct cause of inflation is an increase in the supply of money and credit. When more money competes for the same supply of goods, prices are forced up. Today we have three times as much money and credit in this country as in 1939.

A Federal budget deficit is directly inflationary only to the extent that it is financed by the creation of more money and credit. On the other hand, government-agency loans to foreign countries or to private corporations and individuals at home are inflationary—even if they do not appear as part of the conventional book-keeping budget deficit—to the extent that the loans are not covered out of current taxation. These government-agency loans, in brief, are part of a concealed government deficit.

All government expenditures go in the first instance to specific people and industries. The total inflation today, therefore, may be said to be caused by four major specific inflations: the armament inflation, the farm inflation, the export inflation, and the housing inflation.

They all have one thing in common. Regardless of the original purpose for which any of these programs was started, they have all created a special vested economic interest in their own continuance on the present scale. Thus the foreign-aid program was started to "put Europe on its feet"; but it is now argued that it must be continued to keep our artificially inflated export trade boom from collapsing.

The outstanding case is housing. There would have been a huge private housing boom today even without "government aid." But the government decided to give the boom continuous shots in the arm. The result has been to skyrocket costs out of all proportion to the increase achieved in production. As Marriner S. Eccles, governor of the Federal Reserve Board, pointed out on March 15, the government has turned to "the creation



of new money to finance construction at a time when activity is already fully utilizing available supplies of material and labor.”

In articles in *The New York Times* of July 9, 10, and 11, Paul P. Kennedy ably summarized the major inflationary devices to which the Federal government has resorted to keep the housing boom at a peak. These include everything from high mortgages at low interest rates to direct subsidies. Under the 1950 National Housing Act “the builder, on pure speculation, may receive a construction loan of 85 percent. This loan is insured up to 95 percent of his price when he finds a government-insured purchaser. Thus the extreme limit of his speculation becomes 5 percent on a product in which the gross profit can go several times higher.”

Once this kind of inflationary boom is established, the politicians don’t dare let go. They now express the fear that “any appreciable slowing up of building now would have a telling effect on the entire economy.”

The present government-financed housing boom, in short, is a perfect illustration of the political naïveté of all the “compensated budget” and “compensatory economy” theories. Well-meaning proponents of these theories now protest that what they proposed was government deficits, pump-priming, or housing programs only in bad times, not in booms. But they reckoned without the politicians, who must be entrusted with such programs. Office holders want to stay in office. They are enthusiastic for any proposal that gives them the credit for starting a boom, but never for one that makes them take the responsibility for stopping it. No matter how dangerous the inflation they have started becomes, they keep it whipped up for fear of the consequences of letting it sag. But this only increases the danger and havoc of a subsequent bust.

The “compensated economy” doctrine, because it rests on merely mechanical reasoning, has inherent economic weaknesses too. But because it overlooks the psychology and interest of the politicians, the irony is that the doctrine seems likely to end in practice either in increasing the violence of business fluctuations, or in driving us toward rigid government controls to prevent this. ❁

## Program for the Crisis

July 31, 1950

President Truman showed moral courage as well as good sense in ordering a slowdown in the Federal government’s own program of artificial stimulation to

housing. He showed good sense also in not asking for price controls and consumer rationing now.

But it was doubtful wisdom to threaten the imposition of price controls and rationing “if a sharp rise in prices should make it necessary.” Such a threat could help to bring about the very price rise that he fears; because many consumers may take it as a hint to hoard before the rationing starts.

The proponents of price controls completely ignore the vital regulating function that prices play in a war-time no less than in a peacetime economy. Higher prices reward and stimulate the production of the key war commodities at the same time as they discourage and penalize wasteful consumption. As I pointed out in this column of July 10, it is precisely the shift in *relative* prices that tends to produce the quickest transformation from a peace to a war economy. Prevention of a *general* rise in prices is to be achieved, not through the imposition of price controls, but through money and credit policy.

The chief result of overall price ceilings is not to speed up a war effort but to entangle it in red tape. The economy then breaks out with all the diseases so familiar under OPA: lopsided and unsynchronized production, delays and shortages caused by dilatory or inept price-control decisions, needless deterioration in quality, discriminatory decisions as among different producers, and other abuses.

Here are some parts of an economic program for the present crisis:

1—No mere token contraction of the government’s own housing program, but the total suspension of this inflationary stimulus for the duration of the crisis.

2—Suspension of our arms aid to any country not interested enough to send even a token force to Korea.

3—Suspension of the whole ECA gift program as at present set up, and its conversion to an exclusively arms-aid program—and then only to European countries which are actually sending military aid to Korea and increasing their military expenditures correspondingly. There is no excuse for scattering money around the globe for the vaguely defined purpose of “halting Communism” as long as the crucial place to make sure that it is actually halted is on the Korean battlefield.

If it is really the “United Nations” that is now conducting a “police action” in Korea, it cannot do this by the mere fiction of having armies made up almost exclusively of American boys fighting and dying under a United Nations flag. The chief hope of preventing a third world war is to convince Stalin right now that if he or his puppets make an aggressive move anywhere, they will have to fight not merely us but the rest of the

world. But the other members of the United Nations are most likely to convince him, not by offering to mediate or even by applauding our efforts from the sidelines, but by their own participation in the struggle now.

4—The Point Four program, which even on the rosier view looks toward a remote future, should be completely suspended until the Communist military adventure has been halted in South Korea. Until then it would be an indefensible dissipation of funds. If there is anybody to whom we need to show our “know-how” at the moment, it is to the North Korean Communists.

5—Put real credit control into effect. Limits to installment buying and curbs on commodity speculation are mere token controls. They divert attention from what is really needed. We must restrict high-powered credit before we worry about merely derivative credit. We must restrict commercial bank credit, and above all Federal Reserve credit. We must put an end, especially, to the highly inflationary government bond-pegging policy.

Until the Federal government is willing to accept these suspensions of its own inflationary measures, it is not consistently entitled to ask Congress for stringent priority and allocation powers over business. ❁

## War Measures—Or Hysteria?

August 7, 1950

From laxity and unconcern prior to June 25, Washington has swung over to hysteria. Technically we are still fighting only a “police action” in a tiny country. Yet Washington acts as if our only hope of national survival lay in immediately turning our whole economy inside out and frightening to death the very corporations responsible for our unparalleled production. The proposed measures into which Congress is being stampeded reflect not so much real war necessities as the familiar demands of a statist and controlist ideology.

Congress should, of course, appropriate without delay whatever additional amounts can be spent quickly without misdirection or gross waste. But even if all of the President’s additional appropriation request of \$10,500,000,000 is really necessary, is it also necessary that the Federal government should add that net amount to the expenditures it had already planned? Most of the bureaucrats and congressmen who are so sternly calling on the consumers and taxpayers for more sacrifices are singularly silent about any cut in their own pet programs for handing out taxpayers’ money to pressure groups or diverting resources to inessential

“welfare” or pork-barrel projects. Apparently, aside from mere token cuts, these are to go on as usual.

Yet Arthur Krock, writing in *The New York Times*, considers \$7,000,000,000 a “moderate” estimate of what could be cut from the Fair Deal budget if some of its programs were suspended during the crisis.

Nor is the nonmilitary budget the only one that needs to be critically examined. The American public is entitled to a much more convincing explanation than has yet been offered of why the almost \$50,000,000,000 spent on “defense” in the four fiscal years since July 1946 bought apparently so little of it. The sum is not negligible. We spent on defense in the last fiscal year alone as much as we spent in the whole sixteen fiscal years before Pearl Harbor.

The chairman of the House Armed Services Committee now wants to know “just what” there is on hand to show for the military expenditures of the last four years. This is a laudable, if belated, curiosity. One would have supposed that a committee properly carrying out its responsibilities to the American people would have been checking on this at least every quarter. The armed services committees urgently need a numerically adequate permanent full-time staff of military experts and investigators, responsible to Congress alone, to check on the requests from the services and to know at all times how much defense the people are getting for their money.

The ideological hysteria of the moment is reflected in the demands, even on the part of so-called conservatives and professed believers in a free enterprise system, for overall government economic controls, including a blanket “freeze” of prices and wages. Such demands stem from a complete misreading of the lessons of the last war. These controls and freezes would tie the economy in red tape. They would delay or prevent the very price and wage readjustments that are most necessary. It cannot be pointed out too often that the only way to control the *general* level of prices is through money and credit policy.

The Administration has still to show real awareness of how serious, compared with present practices and proposals, money and credit control would have to be to accomplish this purpose. It must begin with restraints on the Treasury and Federal Reserve System. We must severely limit the expansion of credit by the Federal Reserve Banks themselves. These banks must abandon the inflationary policy of cheap money rates and government bond-pegging. The government must shut down on all new loans from the RFC or the Export-Import Bank. Commercial bank credit must be restricted by allowing interest rates to rise, by

tightening reserve requirements, and by scrutinizing new loans. Demands for installment-credit and real-estate mortgage control only divert attention from these more serious credit controls. ❁

## The Fraud of Price Control

August 14, 1950

Congress is being stampeded into granting—in fact, into forcing upon—the Administration all-out controls over the American economy. These would include not only powers to allocate and ration but to impose an overall freeze on prices and wages. The selling label for these powers is “total mobilization.”

The contention is that unless price controls are slapped on instantly there will be a runaway inflation. This fear rests on a lack of understanding of economic cause and effect. If the government refuses to print more money, or to permit an expansion of credit, then the average level of prices can rise very little or very briefly, even in wartime. For if civilian consumers and the government have between them no more money than before, then the more they pay for some commodities the less they can pay for others. Except within narrow limits, a *general* advance in prices is not possible unless the supply of money is increased correspondingly to finance it.

To seize on price control, therefore, in peace or war, as the way to “fight inflation,” is to adopt a fake remedy as disruptive as it is irrelevant. If the government adheres to noninflationary money and credit policies, general price control is not necessary. If, on the other hand, it resorts to money and credit inflation, any attempt to offset the effects by price control is worse than futile. Price control always restricts, unbalances, and disorganizes production. It brings artificial shortages. So far from “mobilizing” the economy, or speeding it up, price control puts it in a strait jacket.

General price control is at once an ineffective and a crippling device by which a government pretends to protect its citizens against the inescapable consequences of its own fiscal and monetary policies. But it has the merit for the bureaucrats of deflecting attention from their own irresponsible monetary policies onto private scapegoats known as “profiteers.”

It was assumed during the last war that the high prices were primarily the result of war scarcities. They were not. They were primarily the result of the overissue of money and credit. In the five years since the end of the second world war we have been producing goods in vastly greater volume than in the period from 1935

to 1939. This June, in fact, according to the Federal Reserve Board, industrial production was running at 199 percent of the 1935–39 rate. Yet retail consumer prices were 70 percent *higher* in June than in 1935–39.

Why did we have higher prices with more abundant goods? We don’t have to go far for the answer. There is in existence at present more than three times the volume of money and credit as in 1939. It is this increase in monetary purchasing power, brought about by government policy, and not a continuance of war shortages or so-called “profiteering,” that caused the high prices prior to June 25 of this year.

The Administration’s real duty now is not to start dictating prices and wages but to halt its own inflationary policies. It must ruthlessly slash needless non-military expenditures. Senator Byrd, in an itemized statement, has estimated that the whole appropriation of \$10,500,000,000 that the President requested could be taken out of the present nonmilitary budget.

This is the Administration’s economic job No. 1. The government must stop holding up prices of food-stuffs artificially; it must stop financing an inflationary housing boom; it must stop subsidizing an inflationary export boom. It must stop its inflationary government bond-pegging policy; it must stop its inflationary low-interest rates. Both the Federal Reserve System and the commercial banks must tighten down on new credit. Present hostilities and preparedness must be financed as far as possible out of taxation, or out of bonds paid for out of real savings. Congress should authorize the Administration to levy during this fiscal year excise taxes ranging as high as 50 percent on civilian nonessentials.

If such steps are taken we need not fear inflation, and we will get the all-out production that only free markets and a free economy can provide. ❁

## Transform EGA

August 21, 1950

It obviously makes no sense today, as Senator Byrd has pointed out, to convert our own economy to a restricted wartime basis, and at the same time to continue to spend nearly \$4,000,000,000 to build up Europe’s economy on a peacetime basis. Yet this is still substantially what we are planning to do.

As late as June 21, the Senate committees of Foreign Relations and the Armed Services, “after hearing the testimony of Administrator Hoffman concluded it would be unwise to divert” any EGA funds from



their original civilian-welfare purpose to the military aid program.

Tucked away in the table of this report are two columns of extremely significant figures whose significance the joint committee apparently did not consider great enough to call attention to in the text. I reproduce them here. The column TNI represents the percentage relationship of the military expenditures of each country to its total national income. The column TGE represents the percent of military expenditures of each country to its total government expenditures:

	%TNI	%TGE
United States	6.9	36
Belgium	3.8	12
Luxembourg	3.0	8
Denmark	1.8	13
France	7.9	21
Italy	5.0	19
Netherlands	9.1	27
Norway	3.2	14
Portugal	6.0	30
United Kingdom	7.4	20

These Western European countries are in far greater and more immediate peril from Russian aggression than the United States. Yet they have been spending only an average of 5 percent of their national incomes on defense. Even more indicative of the dream world in which they have been living is the second comparison. While 36 percent of our own government expenditures were going into defense, even prior to the Korean war, these nine countries were devoting to military defense an average of only 18 percent of theirs.

In the face of their country's obvious peril, in other words, these governments have been devoting less than a fifth of their expenditures to defense and spending the other four-fifths largely on socialistic experiments—especially to cover the deficits of their nationalized industries.

It may be politically and diplomatically impossible to terminate EGA now. But at least it must be converted at once into an exclusively arms-aid program. And we must ask in return for far better assurances that so-called arms-aid funds will actually add to the might of European armaments.

For our arms-aid funds, of course, do not necessarily add to Europe's defense simply because they are specifically earmarked for defense. If an aided European

government merely spends the same amount on defense that it would have spent out of its own funds anyway, this means that our arms aid has simply released that government's own resources for additional nondefense expenditures. To assure that we are not throwing our arms aid away on nations with no will to use it, a good rule might be to make only those governments eligible that agree to devote at least as great a proportion of their total expenditures to defense as we do. It is impossible for us to help defend Europe unless Europe is determined to defend itself.

If any European country is unready to give evidence, right now, that it is willing to fight Communist aggression, by sending at least token aid, including men, to Korea, or if it complains that it cannot afford to increase its armament expenditures just now because it must first improve its standard of living, we can simply suggest that it will have to do that without our help.

By importuning the European governments to rearm with our money, we are giving some of them the dangerously perverted impression that they are rearming not for their own survival, but as a favor to us. The governments of Western Europe, even more than our own, need to awaken to realities before it is too late. ☸

## Some Notes on War Taxes

August 28, 1950

Overall price and wage control would not only unbalance and disrupt production. It would divert public attention away from the only real remedy for inflation, which is to refrain from expanding money and credit.

We are not likely to do this unless we bring the budget to a balance or near-balance. There has been some recognition of this need in Washington, but the emphasis has been thrown in the wrong place. It has been all on imposing still more drastic taxes, with at best a perfunctory acknowledgment, unaccompanied by serious action, of the need for reducing non-military government spending.

Any congressman who still doesn't know where these non-military economies could be effected might consult the August letter of the National City Bank of New York. "With the widespread anxieties over possible shortages," suggests the bank, "expenditures of \$1,066,000,000 in public funds to hold up [farm] prices and remove agricultural products from the market seems more than ever indefensible." It goes on to recommend cutbacks in the new "welfare" programs which the President proposed to launch this year, in



the record-breaking \$961,000,000 “rivers and harbors” bill, and in civilian ECA.

If such economies were made, the problem of increased taxation would prove far less formidable than it appears at present.

Two forms of war taxation deserve careful study. The first is the so-called “excess-profits” tax. It would promote clarity of thought to call this, rather, a war-profits tax. Zealots hostile to free enterprise regard almost any profit as “excessive,” and seize on the phrase “excess-profits” tax to put forward punitive schemes which have nothing to do with war. A war-profits tax is simply an effort to skim off most of the windfall profits due to war itself.

How are we to identify such profits, however, and segregate them from those that would have been made anyway had peace continued? It has been usual to regard as specifically “war profits” all profits made in excess of those in the three or four years before the war. There is a plausible presumption in favor of this. But in no case can one be sure that the presumption is more than roughly correct, and in many cases it is unjustified. In all growing industries (e.g., television) at least part and perhaps all of the increase in earnings would have occurred anyway.

There is talk of applying the principle of a war-profits tax not merely to corporate but to individual incomes. This would no doubt be consistent. But it would clearly apply unjustly in many cases—to people with fluctuating incomes, say, and particularly to young workers who would have been promoted to higher-paying jobs even in peacetime. Should a lower absolute corporate or individual income be taxed more than a higher income, even in the event of war, simply because the recipient is not accustomed to it? We must remember, finally, that a drastic corporate “excess-profits” tax, as we learned during the last war, encourages higher costs and a wasteful use of men and materials.

Particularly appropriate to wartime, however, is an excise tax on civilian-consumption goods. This should be charged separately to the consumer, and labeled a war-purchase tax. Congress might fix a minimum uniform tax on all goods except foodstuffs (say 2 to 5 percent) and authorize the Administration to impose an added tax in its discretion, at any rate up to a maximum of 50 or even 100 percent, on any luxury or other product the civilian production or consumption of which it wished to discourage in wartime. This would be a far more flexible and less disruptive way of dealing with certain commodities, such as gasoline, sugar, and rubber, than the hit-or-miss rationing of the last war.

To prevent such a war-purchase tax from becoming a permanent part of the tax structure, Congress should grant such a power for not more than a year at a time, and should retain, in addition, the right to terminate it even before then by a vote of either House. ☼

## Sham Fight against Inflation

September 4, 1950

While the Administration is demanding and getting fake weapons and needless powers to “fight” inflation, it is driving ahead with the very policies that produce inflation.

Inflation is directly caused by an increase or expected increase in the supply of money and credit in relation to the supply of goods—and (apart from deterioration also in the *quality* of money) *by nothing else*. All other so-called causes or “pressures” are at most only indirect.

One of the most important of these indirect causes is a governmental cheap money policy. Artificially low interest rates increase the demand for loans—particularly from marginal productive or marginal speculative ventures. This means the creation of more bank deposits—i.e., of more money bidding for goods—of more inflation. The Treasury insists on continuing precisely such a policy.

In the last decade the Federal Reserve System has been used primarily as a huge engine of inflation. The Federal Reserve authorities have been subservient to the Treasury. They have carried out its shortsighted interest-rate policies and allowed the banking system to be used as a dumping ground for government securities. This is the chief way in which the nation’s volume of money and credit has been more than tripled between 1939 and the present. This is the primary cause of the inflation of the last ten years.

But on Aug. 18 the Federal Reserve Board increased the discount rate of the Federal Reserve Bank from 1½ percent (a fantastically low rate in the face of inflationary danger) to 1¾ percent. This was a very cautious move indeed—but it was in the right direction. Its chief importance was symbolic. Yet the Treasury on the same day moved in precisely the opposite direction. It announced that it would offer \$13,570,000,000 of thirteen-month notes at only 1¼ percent interest. And Secretary Snyder publicly reproved the Board’s anti-inflationary gesture. “A stable and confident situation in the market for government securities is our first line of defense on the financial front.” He added that we must

“fulfill our responsibility to the millions of Federal security holders throughout the nation.”

But this merely meant that Mr. Snyder was putting low borrowing rates for the Treasury ahead of every other consideration—including the certainty that this policy must produce still more inflation. To maintain artificially low interest rates not only encourages general inflationary borrowing; it compels the banking system to support and load itself up with U.S. government securities issued at such rates. The Federal Reserve Banks now hold \$18,577,000,000 of these, and the country's commercial banks more than \$66,000,000,000. The money and deposits created against these securities are the chief reason why present wholesale commodity prices are more than double those of 1939. The Federal Reserve Banks at that time held only \$2,484,000,000 in government securities and the commercial banks held only \$16,000,000,000.

Mr. Snyder's belief that his bond-pegging and low-interest policies protect Federal security holders is the exact opposite of the truth. It is mainly because of these very policies that every dollar invested in Federal securities in 1941 has a purchasing power of only 61 cents now. This is a real depreciation of 37 percent.

Nothing can now prevent a serious inflation except a termination of the Federal Reserve and Treasury policies of the last decade. Interest rates must be allowed to rise. Government bond-pegging at present rates must be abandoned. The Treasury must sell its bonds to nonbank investors. The reserve requirements of the Federal Reserve Banks must be restored at least to the old 35–40 percent level, and preferably put even higher. And when the government has made these self-denying reforms, the reserve requirements of the commercial banks must be tightened.

If these measures are taken we will not need price controls against inflation. If they are not taken, price controls, as in the past, will be worse than futile. They are false anti-inflation weapons. They merely impede, unbalance, and disorganize production. ❁

## Dilemmas of Price Control

September 11, 1950

Before passing the economic controls act, Congress got into a last-minute snarl over whether it should insist on “across-the-board” price- and wage-fixing, or permit “selective” price-fixing. The truth is simply that there are dilemmas in either course.

“An overall ceiling across the entire economy” is the Baruch proposal. Its purpose is to insure that “prices,

wages, rents, fees, and so on” will be controlled in an impartial, non-discriminatory, nonpolitical manner. Baruch thinks he would insure this by recommending that all prices and wages be “rolled back” to and frozen as of June 25, the day hostilities broke out.

But the proposal has fatal defects. It ignores the whole function that free prices, free wages, and free markets play in our economy. That function is to direct production into the goods that are most needed and away from the goods that are least needed. Free prices provide a wonderfully flexible but inextricably interrelated system of incentives and deterrents, which constantly balance and synchronize production as among thousands of different commodities. The free price system provides a voluntary and “automatic” allocation of capital and labor.

The Baruch plan would try to freeze for wartime the price relationships that were adapted to a past situation in peacetime. It would prevent the very adjustments necessary to get the immediate, voluntary changes in the structure of production that war requires. It would force the government into compulsory rationing of materials and labor—into allocation problems of bewildering and unmanageable complexity. It would drive us straight back to the absurdities of the last war, when OPA was controlling the price of oyster shells and Cadillacs, mink coats and paper clips. The Baruch plan would strait-jacket production. It would dangerously retard, not advance, the prosecution of the war.

And it would not even, in the end, have the one merit of being politically nondiscriminatory. Labor would not tolerate the compulsions involved. Demands would come from every side for the correction of “hardships” and “inequities.” Many of these demands would have undeniable merit. But once the door was opened every powerful pressure group's demands would be granted under the euphemism of “correcting inequities.”

It must be pointed out once more that if credit control were tight enough, there would be no need for blanket price and wage control, because the general level of prices would not rise. The *relationships* of individual prices and wages to each other would change, of course, as they should. On the other hand, if money and credit are substantially expanded, blanket price controls are worse than futile. In the end they break down, but they constrict production in the meantime.

If we try to avoid the evils of blanket price control by “selective” price control we merely create other evils. Selective price control becomes political and discriminatory almost at once. It becomes an excuse for holding down prices while permitting or encouraging wages to rise. And in the long run the price of a finished

commodity can be held down only by controlling also the price of the raw materials and labor that go into it, the prices of substitute products, and so on. Selective price control, once inaugurated, tends to spread in ever-widening circles toward blanket price control.

But suppose the price of a particular product starts to soar above the level thought necessary to insure the required production of that product? This is the most plausible case for selective price control. Even here a better solution would probably be a heavy excise tax on that product. Such taxes could be either a flat percentage of the whole price of the product, or, say, 75 percent of the amount by which the price exceeds that considered necessary to bring out sufficient production of that product. Congress, in wartime only, could delegate to the Administration discretion to levy such flexible taxes. These taxes would discourage wasteful consumption, reduce war profits, and increase revenues to the government. ⚙

## Shadow-Boxing with Inflation

September 18, 1950

Neither Congress nor the Administration can take any legitimate pride in its economic or fiscal record since the outbreak of war in Korea.

Congress failed to provide for control of what most needs control. It provided controls that are not needed and can only create confusion or harm.

What is needed is the most stringent credit control. Without this, inflation is certain. With this alone inflation can be halted. Yet Congress provided only for the control of derivative credit, such as installment buying and real-estate mortgages. It did nothing to curb the expansion of the money supply or bank credit at the source.

When everyone in the Administration and in Congress professes to be “fighting inflation,” and when the average combined reserve ratio of the Federal Reserve Banks is still 54 percent, it is a scandal that the Federal Reserve authorities should be permitted to retain the “emergency” legal reserve ratio of only 25 percent adopted in 1945. The minimum ratio requirement should now be restored to at least the former levels of 35 percent against deposits and 40 percent against notes. And the Treasury must be prevented from continuing to float its securities by inflationary means. Until such measures of self-restraint are adopted by the government itself, all its other so-called “anti-inflation”

measures or exhortations must be set down as hypocritical and futile.

At least lip service, it is true, has been paid in Congress and the Administration to a balanced Federal budget as a preventive against inflation. But apart from the protests of a small Congressional minority symbolized by Senator Byrd, virtually all the emphasis has been thrown on getting this balance by still more crushing taxation. When Congress directed the President to cut his proposed annual expenditures by about 1 percent, to be taken out of the nonmilitary budget, Mr. Truman called the requirement “arbitrary” and didn’t see how he could conform with it “without impairing essential government services”! It is only the taxpayer, apparently, who is to be told that he will just have to learn how to get along on less. The austerity is to be all his; political pork must not be touched.

The same government that is crying for more power to keep down prices is still using hundreds of millions of the taxpayers’ money to keep food and other farm prices high. And when every spare dollar and resource is needed for defense, we are still handing out billions to European bureaucrats to enable them to play with more civilian “welfare” schemes.

The Defense Production Act embodies the false economic theory that the way to combat monetary inflation is through blanket price control. Its idea of “total mobilization” is total government restraints. Price control at best is an effort to “combat” inflation by disregarding its causes and attacking merely its symptoms. The chief effect even of “impartial” price control is to cut production. But in addition the new measure is frankly discriminatory. Explicit protections are written in for farm prices and wages. If these are justified, why shouldn’t they apply equally to all prices? The President, for example, is explicitly directed not to fix any wage below that paid in the month prior to June 25. Why not the same restriction on his price-fixing powers for all prices?

In fixing prices or wages the President is authorized to “make such adjustment as he deems necessary to prevent or correct hardships or inequities.” This is the door through which every political pressure group will try to pound its way. Union leaders, of course, will argue that the whole wage level was “inequitable” as compared with the price level before June 25.

In spite of the Lustron loan and other RFC scandals, the new act authorizes \$2,000,000,000 more—\$600,000,000 of it under virtually uncontrolled Presidential discretion—for loans to private firms



whose credit isn't good enough to get loans from private investors or banks.

The best provision of the Defense Production Act is the expiration of at least part of it on June 30, 1951. This will give an early opportunity for sober reconsideration by the new Congress. ❁

## When Prices Go into Politics

September 25, 1950

In their ostentatious "fight against inflation," Congress and the Administration have made nearly every wrong decision possible.

The direct cause of inflation is an increase in money and credit. Practically every other cause is indirect; it operates through this. Yet in its economic-controls law Congress did nothing to prevent expansion in the *total volume* of money and credit. Nor did the President in his radio talk on the law say a single direct word on the necessity of limiting the total quantity of money and credit. Congress legislated specifically only on such derivative forms of credit as consumer installment and housing loans. And the Treasury insists on financing the war by methods that must swell the volume of money and bank deposits.

Mr. Truman rightly insists that we should pay for defense "as we go." But the budget balance he speaks of is entirely to be achieved, apparently, by an increase in the already ominous burden of taxes. Not once did he mention a cut in the government's own unparalleled nondefense extravagance. The sacrifices are all to come from the taxpayers, and none from the bureaucrats or pressure groups that live at their expense.

"The supply of civilian goods will not keep pace," Mr. Truman blandly predicts, "with the growth of civilian incomes. In short, people will have more money to spend, and there will be relatively fewer things for them to buy. This inevitably means higher prices. . . ." He neglects to say that this will happen only if the government itself continues to spend wastefully or fails to tax away from civilian incomes the amount needed to pay for defense. The way to prevent inflation is to prevent a gap from developing between civilian incomes and civilian goods—not by the hoax of price control.

Not only the Defense Production Act, but Mr. Truman's radio speech and executive orders foreshadow political discrimination in price and wage control. Mr. Truman tells the businessman: "Hold your prices down." But he tells the wage earner: "Do not ask for wage

increases beyond what is needed to meet the rise in the cost of living." This sets a double standard. What would have been thought had he reversed it, and said to the unions: "Hold your wages down," and to the businessman: "Do not ask for price rises beyond what is needed to meet the rise in other prices"?

This double standard is not inadvertent. It appears in the text of the President's executive orders. Sec. 401 (b4) provides that the Economic Stabilization Administrator shall "establish price ceilings and stabilize wages and salaries where necessary." It does not say either that he shall establish wage "ceilings" or that he shall merely "stabilize" prices. Is different language applied to the two cases for any other purpose than to discriminate in favor of wages as against prices?

Moreover, the Administrator can "establish price ceilings" all by himself, but before "stabilizing" wages he must consult a Wage Stabilization Board of nine members, three to represent labor, three industry, and three "the public"—all appointed by Mr. Truman. For any businessman to raise his prices unless his costs have increased correspondingly is, Mr. Truman thinks, "just plain profiteering." No such harsh label is applied to unions that raise wages more than living costs. On the contrary: "Existing inequities in wage rates, of course, can and should be corrected." If experience in the last war is any guide, all "inequities" in wages will be straightened out by raising the lower wage, never by lowering the higher, and the government will allow wages as a whole to push up while it tries to hold down prices and squeeze profit margins.

Of course neither the honest advocates of "selective" price control nor the doctrinaires who want "an overall ceiling across the entire economy" approve of this kind of political discrimination. But what both of them overlook is, first, that price control, selective or overall, is a spurious remedy for inflation, and, secondly, that once we put in the hands of politicians the power to say what specific prices and wages shall be, that power will inevitably be used as a political weapon. ❁

## The Need for Credit Control

October 2, 1950

In understanding the real causes of inflation and recommending the means for combating it, one Federal agency has come nearer to realities than any other. This is the Federal Reserve System, which after ten years of



subserviency is at last rebelling against the Treasury's reckless inflationary cheap-money policy.

The best discussion I have read by any Federal official of the true causes and preventives of inflation is a lecture by M.S. Szymczak, a governor of the Federal Reserve System. The lecture was delivered on Aug. 29 before the School of Banking of the University of Wisconsin. An extensive excerpt from it was published by *The Wall Street Journal* of Sept. 11.

"I do not believe," he declared, "[direct] controls [including price and wage fixing and rationing] are the present answer to our immediate inflation problem. They deal only with effects and not with basic causes. The basic cause of our inflationary problem is continuing rapid credit and monetary expansion, abetted by current government deficits which threaten to grow larger and larger. . . . If the fuel of inflation is provided, all that direct controls can do is to drive the inflationary pressures underground and to postpone some of their effect. . . .

"The cornerstone of our anti-inflation program must be bold fiscal measures. . . . Financing the expanded military budget cannot be limited to the taxation of wealthy individuals and business enterprises if it is to be useful as an effective anti-inflationary measure. It must restrict spending, and most spending is done by the vast number of individuals and families with low- and middle-bracket incomes. In an emergency situation like the present, our tax changes must be designed primarily to meet the danger of inflation."

Szymczak goes on to recommend debt-management policies designed to tap real savings by sales of government securities to non-bank investors, so as "to reduce the volume of government financing through banks, which is highly inflationary." He endorses the restriction of consumer and real estate credit, and the action of the Federal Reserve System in August of raising the New York and other discount rates from 1½ to 1¾ percent. If the measures so far taken are not effective, he adds, "monetary policy will need to resort to even more restrictive use of one or more of the general instruments of credit control at its disposal, namely, open-market operations, changes in the discount rates, and changes in bank-reserve requirements."

All this is excellent as far as it goes, and Szymczak and those for whom he speaks in the reserve system deserve great credit for their courage and clearheadedness in going even this far. But Federal Reserve officials are still the prisoners of their own submissive record of the last ten years.

The official statement of the Board of Governors on Aug. 18, for example, declared that they were prepared

to use all the means at their command to restrain further expansion of bank credit "consistent with the policy of maintaining orderly conditions in the government securities market." Now this phrase is ambiguous. If we may judge by its interpretation in the past, it is little more than a euphemism for saying that it is the duty of the Federal Reserve System to continue to support government securities at substantially their present artificial inflationary low interest yields. And if this is Federal Reserve policy, it cancels bold words about fighting inflation with "all the means at our command."

It is the duty of the Treasury itself to make the market for its securities "orderly" by paying rates of interest that will appeal to real investors and—if necessary to protect existing holders—by refunding its outstanding long-term securities at higher rates or even, perhaps, as an emergency measure, with securities bearing a variable coupon rate (see this column, *Newsweek*, Oct. 4, 1948).

The country cannot continue indefinitely to be the victim of the Treasury's past as well as present inflationary cheap-money policy. That policy must be terminated now. ☸

## Communism Imitates Capitalism

October 9, 1950

The latest Bulletin of the Soviet Union's Academy of Science reveals, according to Harry Schwartz in *The New York Times* of Sept. 24, that Russian bureaucrats are trying to fix their socialist prices on capitalist principles.

"Prices charged by Soviet enterprises must now be set high enough to cover costs and to permit profits to be made," reports Schwartz. "In addition they must be based on demand and supply so that prices for scarce commodities will be sufficiently high to stimulate increased production and reduce consumption of such scarce items.

"But these prices are still determined by planning authorities rather than set in markets through the interplay of competitive forces. These principles were apparently used to help frame the major revision of the Soviet wholesale price structure [in 1949 and] this year. During and immediately after World War II Soviet economists boasted that wholesale prices of industrial commodities had remained stable. Only later did they reveal that this policy had been possible because of very large government subsidies to many plants."

To those who have followed the discussions of the more enlightened socialist theoreticians over the last two decades, not to speak of those who have peered

behind some of the curtains of propaganda to the economic realities in Russia, none of this will come as a blasting revelation. Socialism and Communism began as a revolt against the alleged folly and iniquity of capitalism and the free market. The supreme irony is that, once the socialist and Communist theorists had finished their joyous work of destruction in the countries where they had seized power, and were called upon to buckle down to the task of producing the economic paradise which their rhetoric had so long and confidently promised, they found themselves forced, in the end, to try to imitate and revive the very price system they had so eagerly destroyed.

The whole problem is one of which the cocktail-party socialists are blissfully unaware. As long as there is only partial socialism, as in the Western democracies, the problem can be concealed. The city-owned New York subways, for example, are run at a deficit; but the city merely forces property owners, and the private industries within its boundaries that are run at a profit, to make up the deficit. The nationalized railroads of Britain and France are run at a deficit, but the British and French Governments can simply force the profit-making private industries in their countries to pay that deficit. (Of course today, with ERP, they in effect get their nationalized railroad deficits paid for out of the profits of private *American* business.)

There are many other ways in which partial socialism can camouflage its deficits. Nationalized enterprises don't make the same kind of deductions for interest, depreciation, and taxes that private industry is forced to make. The Labor government can increase the apparent productivity of the British coal mines by mechanizing those mines at the expense of private projects in which the new capital could be used to more advantage. Or the government, because of its monopoly, can raise coal prices, and so force consumers to make up a hidden deficit by what is in effect a stiff excise tax on coal.

But none of these devices are open as a general practice in a country where socialism, as in Russia, is virtually complete. Partial socialism is parasitic on capitalism; but complete socialism is forced to be self-supporting. A deficit in one part of the socialist economy can only be made up at the expense of another part.

And so, in present-day Russia, the Communists find themselves compelled to imitate the very "profit system" they have spent their lives denouncing. But their imitation, unfortunately for them, can't take the place of the real thing. Under their system, in which wages, prices, and interest rates are all arbitrarily set by bureaucrats, they can never know what their real costs are, or even what real consumer demand is. They must

play capitalism, competition, price and profit system, the way children play house. Only their game is more like blind man's bluff. ❁

## Canada Takes the Lead

October 16, 1950

The decision of Canada to permit a free market in its dollar may be the first real break in the ice jam of international exchange control.

Exchange control is a totalitarian device first systematically applied by Schacht in Nazi Germany, then endorsed by the late Lord Keynes of Britain and embodied, under his leadership, in the International Monetary Fund.

The Fund was Keynes's proposed substitute for the gold standard. The gold standard was a triumph of international cooperation. It established in effect a single world currency. For when each country's monetary unit was convertible on demand into a fixed weight of gold it was also necessarily convertible at a fixed rate into all other monetary units. And the monetary managers of each country could keep their currency on gold only by refraining from inflation or any other act that undermined confidence.

Keynes was opposed to all this, partly because he was at heart—as he confessed in an article in the *Yale Review* in 1933—an economic isolationist. He resented having England's internal price level tied to the international price level. He dreamed of a system in which England's monetary managers could manipulate their own internal price level—by inflation and devaluation—so as to keep constant "full employment" at home regardless of what was going on in the rest of the world. And he actually succeeded in selling to the world's assembled monetary "experts" at Bretton Woods the idea that gold convertibility was not needed to sustain or stabilize a currency's value—that the purchasing power of engraved scraps of paper could be made whatever the monetary managers of that country chose to say it was. But to peg them for a while he proposed the Fund, an institution pledged to use the relatively hard currencies (chiefly the U.S. dollar) to buy the soft currencies at whatever arbitrary valuations their governments put upon them.

This system had to be supported by exchange control—that is, by using each government's police power to forbid anybody to buy or sell its currency at any other than the arbitrary official value put upon it. But the breakdown of the whole system is now becoming evident even to the "experts."

Its first effect was to choke and unbalance foreign trade. It produced the so-called “world dollar shortage” which at least one British economist, Roy Harrod, had the courage to call “one of the most brazen pieces of collective effrontery that has ever been uttered.” Even Sir Stafford Cripps eventually profited by the expensive education of events, and slashed the arbitrary value of sterling from \$4.03 to \$2.80 in September 1949—a step which led to the reversal of the sterling area’s balance of payments.

It was a step imitated by some 30 countries, but it fell short of being the right step—which was to set the markets free. And this is what Canada has now had the courage to take.

Canada’s step has been criticized in some quarters because it would mean a “floating rate” that can move up and down every day in accordance with fluctuations of supply and demand and fluctuations in confidence. But the bureaucrats’ headache is the citizens’ salvation. It is precisely the great advantage of a free rate that it compels the monetary managers to act with prudence and foresight and maintain the integrity of the currency at all times. It is precisely because they know that any lapse in confidence will be reflected immediately in the market quotation that the managers of a free-exchange currency are compelled to act with more responsibility than the managers of a controlled one. Because of the public confidence in Canada’s policy, the quotation of the Canadian dollar on the first day of free markets actually rose from the former fixed “official” rate of 91 American cents to a level of 95 cents.

A floating rate for the Canadian dollar is probably intended to be temporary, but it is a necessary transitional step. We will never emerge from the present world monetary chaos until the leading countries return to a gold standard and adopt the measures to create confidence that the gold standard will be maintained. ❁

## ERP Reverses Its Aims

October 23, 1950

Santayana once defined a fanatic as a man who redoubles his efforts after he has forgotten his aims. The definition would apply equally well to the typical bureaucrat or government planner. The history of ERP is an outstanding example.

The Marshall plan began as a mistaken remedy based on a wrong diagnosis. The European bureaucrats contended that their trouble was a “dollar shortage,” and

that the remedy was for the United States to give them dollars. Our own bureaucrats took this at face value and started giving away billions of taxpayers’ money.

But the “dollar shortage” merely got worse. It was being created, in fact, by the very measure ostensibly designed to prevent it—exchange control at absurdly high currency valuations. The European bureaucrats argued that they were losing gold and dollar reserves in spite of their exchange controls, not because of them. But when on Sept. 18, 1949, Sir Stafford Cripps reversed his position overnight and slashed the official value of the pound from \$4.03 to \$2.80, the effect was an almost immediate reversal in the sterling area’s net flow of international payments. Britain’s gold and dollar reserves are now more than double last year’s pre-devaluation level. And in August, for the first month in thirteen years, our own imports exceeded our exports.

Yet though the so-called world “dollar shortage” is curing itself, there is no suggestion from our own ECA that we can terminate or taper off our outward flow of gift dollars. On the contrary, our own officials are still warning us that we must continue to throw our money all around the world even after 1952; they are putting no pressure on Britain to free sterling from controls as the Canadian dollar has now been freed, and they resent hints that British socialism has done anything to offset our aid to Britain.

In 1949 the British nationalized railways lost \$58,000,000. This deficit was paid in fact though not in form by American taxpayers. The funds that we turned over to the British Government to pay for things that it would otherwise have had to pay for itself released \$58,000,000 of its own funds to pay the socialized railway deficit. The end result is the same as if we had paid for that deficit direct. And now the British Labour Party is going to nationalize the steel industry, and create new deficits.

The slightest suggestion that we should refuse to subsidize European socialism is rejected by our ECA bureaucrats as an intolerable interference in Europe’s domestic affairs. But let any European country attempt to move toward a free economy, or toward prudent finance, let it seriously try to protect the integrity of its currency unit, and our ECA bureaucrats will forget all about “noninterference” and berate that country in no uncertain terms.

A *New York Times* dispatch of Oct. 2 from Rome, for example, reports that our ECA officials there are appalled to find that the Italian Government has finally balanced its budget! It is to this, and not to the inevitable hangover from the previous inflationary spree, that



our ECA “experts” attribute present Italian unemployment. “It is absurd for the [Italian] Government to be showing a surplus” now, according to our ECA administrators. They are “particularly disheartened by the slow rate” at which Italy is spending our money! They are urging “larger expenditures” on the Italian Government and “a more liberal policy of investments”—which are Keynesian euphemisms for Government subsidies to private business and for the philosophy of spend and spend and spend.

Our ECA officials find it particularly hard to understand Italy’s “fear of inflation.” They might get some glimmering of light on the subject if they consulted official index numbers, which show, for example, that the cost of living in Italy was 50 *times as high* last year as in 1938 and is still 48 times as high.

Queer people, these Italians, definitely in need of a pep talk from someone like Leon Keyserling. ☸

## Credit Control at the Source

October 30, 1950

The Federal Reserve Banks have kept interest rates abnormally low. They have loaded themselves up with nearly \$20,000,000,000 of government securities. In brief, they have failed to make proper use of the two best ways to prevent credit expansion—by raising interest rates and through open-market operations. So to compensate for this failure they are planning to increase the reserve requirements of member banks of the Federal Reserve System to the limit permitted by law.

Increasing reserve requirements is a clumsy method of credit control. But it is far better than permitting a further inflation of bank credit. It is ironic, however, that the Federal Reserve authorities who want to impose higher reserve requirements on the member banks have resisted every effort to restore the reserve requirements of the Federal Reserve Banks themselves. Prior to 1945, the Federal Reserve Banks were required by law to keep reserves in gold certificates of 40 percent against their notes in circulation and of 35 percent against their deposits. By act of Congress on June 12, 1945, these requirements were lowered to a uniform reserve ratio of 25 percent. This was done to permit the Federal Reserve System to inflate more in the war emergency—though Germany had already surrendered the month before, and the Japanese surrender, as it proved, was only two months off.

Though the reserve authorities never had to resort to the lower reserve ratio, they have not only failed

since then to recommend a restoration of the former reserve requirements, but have opposed all outside suggestions that this be done. Yet the National City Bank, in its monthly letter this September, pointed out that the Federal Reserve Banks could still buy up about \$50,000,000,000 additional government securities—a tremendous inflationary potential—before their note and deposit liabilities would reach the present legal limit of expansion permitted with present reserves.

This situation urgently demands action by Congress. The reserve requirements of the Federal Reserve Banks themselves should be restored at least to their pre-1945 levels. As the average reserve ratio of all the Federal Reserve Banks is now 52.5 percent (from 56.4 on June 21), this legal change can fortunately still be made without causing the slightest hardship.

It is true that this action would do nothing to reduce the already outstanding volume of money and bank credit. Its purpose would be to forestall a further inflationary expansion while there is still time. It would, however, have a tremendous immediate psychological importance. It would put not only the Federal Reserve System but the whole country on notice that Congress is determined to prevent inflation and knows the direction in which the danger really lies.

As long as we have legal reserve *requirements*, they must be *adequate*. A legal reserve ratio is a declaration of Congressional policy. The present reserve requirement of only 25 percent is equivalent to a Congressional sanctioning of further gross inflation. If the Federal Reserve Board has in fact no intention of inflating to this point, it should welcome a restoration of the former reserve requirements.

Of course even if the legal reserve ratios were restored to their former levels, it would still leave a tremendous inflationary potential. This is no reason for not taking this step; it is a reason for taking *additional* measures.

So let Congress restore the Federal Reserve Bank ratio requirements to their previous levels. Or better, let it raise the present flat “emergency” 25 percent reserve requirement against both deposits and notes to a flat 40 percent. Then let Congress in addition give the Federal Reserve Board discretionary authority to raise the reserve requirements of the Federal Reserve Banks even further—just as it already has discretionary authority to raise member bank reserve ratios. And let Congress provide still further that the board cannot hereafter raise the reserve requirements of the member banks without raising the reserve requirements of the Federal Reserve Banks correspondingly. ☸



## The Great American Giveaway

November 6, 1950

In *Newsweek* of Oct. 23 this column pointed out that though the so-called world “dollar shortage” had cured itself, there was still no suggestion from our own ECA that we now terminate or taper off our outward flow of gift dollars. In the same issue *Newsweek* carried an article and charts on the dramatic suddenness with which the “dollar gap” had been closed. Here are some further developments:

On Oct. 22 the joint Senate-House committee on Federal expenditures, under Senator Byrd, reported that \$42,591,000,000 had been expended for foreign aid since V-J Day. This adds up to about \$283 for every American man, woman, and child. It almost equals the cost of operating the Federal government for the whole six years preceding the second world war.

Senator Byrd said these figures were up to the minute and covered 28 programs of military and economic aid. However, they didn't cover other programs that President Truman has in preparation. These are expected to include more foreign arms help, another round of Marshall-Plan assistance, reconstruction funds for Korea, and food for Tito's Yugoslavia. Any reader curious about such matters will find half a dozen new proposals for giving away American money in almost any day's newspaper. Giving away American money still seems to be, in fact, the Administration's main solution for every foreign problem.

Lately, however, the American people have begun to wonder what they are getting for all this money. When they see the dollar weakening on world markets, when they see Britain's “forward” sterling selling at a premium, when they see our (paid-for) imports exceeding our (partly-given-away) exports for the first month in thirteen years, when they see us losing gold at a rate of about \$2,000,000,000 a year, they are beginning to ask just why our officials continue to give away dollars to bridge a gap that has already been closed.

Some of them are beginning to wonder what we are getting in return even for our military-aid programs. Three days before the publication of the joint Senate-House committee report just cited, former President Hoover warned that we “cannot long endure the present drain on our economy.” He bluntly raised the question whether, in view of the actions and statements of their leaders, the nations of Western Europe, outside of Britain, “have the will to fight, or even the will to preparedness.” And he proposed, for one thing, that “we should say, and at once, that we shall provide no more

money until a definitely unified and sufficient European army is in sight.”

Still another recent development has emphasized the fact that the more zealous apostles of the Great American Giveaway in the last few years have not known what they were about. It is only a few months ago that the European Payments Union was started with great fanfare to solve all the problems of intra-European trade. It was on this argument that Congress was persuaded to throw \$600,000,000 of American money into the scheme. And now it is found that West Germany has used up in three and a half months all the credits allotted to it for an entire year's operation of EPU. The union is “faced with a major crisis.” And the suggested solution is that America throw in more dollars.

The real trouble, of course, is that the European Payments Union is a needless and amateurish piece of bureaucratic gadgetry set up on an unsound basis. (See the analyses in this column of March 27 and April 10.) The real solution of the problem with which the EPU was supposed to deal was not still more bureaucratic machinery but the simple abolition of exchange control. This would have brought at once the full and free convertibility of currencies and the expansion and balance of foreign trade that the EPU has failed to achieve.

The final irony of most of our government giveaway programs is that their effect, on net balance, has been to set back, not to advance, world economic recovery and production. ❁

## ‘Bankruptcy’ Is Here

November 13, 1950

How big a national debt can we stand? What will happen if it ever exceeds that figure?

One of the strangest things about these questions is that they are still being put in the future tense, as if nothing important had happened up till now. A typical letter I frequently get reads something like this: “Years ago economists told us that the nation couldn't stand a debt of more than \$50,000,000,000. But now the debt is \$257,000,000,000, and we seem to be doing OK. What about it?”

Congress, it is true, has frequently set a so-called legal debt limit (which could have served a real function as a danger signal), but has as frequently raised the limit as soon as it was approached. Thus in the Second Liberty Bond Act of 1917 it set a legal debt limit of \$45,000,000,000. It increased this to \$49,000,000,000

in 1940, to \$65,000,000,000 in 1941—and it is now set at \$275,000,000,000.

The sad truth is that our government has already exceeded the safe debt limits of the past. It has already in *practical effect* done what a bankrupt—government or individual—always does, which is to make only a partial repayment—to pay its debts off at only so many cents on the dollar.

*In form*, of course, our government has paid off its debts 100 cents on the dollar, and will doubtless continue to do so. It has reduced its repayment in substance, however, by depreciating the dollar itself, the unit in which the debt is measured. According to official index numbers, the purchasing power of the dollar in terms of consumers' prices is today only 57.5 percent of its purchasing power in 1935 to 1939. In other words, a citizen who bought a government bond at par in 1935–39 gets back today in real purchasing power less than 58 cents for every dollar he invested. In still other words, he has taken a real capital loss of more than 42 percent.

We have been following, in fact, precisely the course governments have followed from time immemorial in melting down their internal debts. In *The Wealth of Nations*, Adam Smith, of laissez-faire fame, wrote in 1776:

“When national debts have once been accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid. The liberation of the public revenue, if it has ever been brought about at all, has always been brought about by a bankruptcy; sometimes by an avowed one, but always by a real one, though frequently by a pretended payment.

“The raising of the denomination of the coin has been the most usual expedient by which a real public bankruptcy has been disguised under the appearance of a pretended payment. . . . [In 1776 most governments had not yet learned the easier trick of printing paper money instead of coining hard metals.] A pretended payment of this kind, instead of alleviating, aggravates in most cases the loss of the creditors of the public. . . . It occasions a general and most pernicious subversion of the fortunes of private people; enriching in most cases the idle and profuse debtor at the expense of the industrious and frugal creditor, and transporting a great part of the national capital from the hands which were likely to increase and improve it, to those which are likely to dissipate and destroy it.

“When it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open, and avowed bankruptcy is always the measure which is both least dishonorable to the debtor, and least hurtful to the

creditor. The honor of a state is surely very poorly provided for, when, in order to cover the disgrace of a real bankruptcy, it has recourse to a juggling trick of this kind, so easily seen through, and at the same time so extremely pernicious.”

Smith then proceeds to recite examples of such “juggling tricks” of currency depreciation from Roman times on. He describes in effect what is happening to our own Federal debt today. It is too late to forestall “bankruptcy” of the United States. Our problem is to prevent such bankruptcy from going any further than it has. ❁

## On Taxing ‘Excess’ Profits

November 20, 1950

Though Congress has pledged itself to enact an excess-profits tax, it is fortunate that an interlude for sober thought—and a sobering election—has occurred between pledge and passage.

The term “excess” profits is ambiguous. It may refer either to the excess of wartime over peacetime profits or to the excess of profits over a so-called “fair” return. We must distinguish at the beginning, therefore, between what Senator George (Democrat, Georgia) has called a “true war-profits tax” and “establishing a precedent for a permanent [peacetime] excess-profits tax.”

To penalize high profits as such is basically hostile to private enterprise. Any standard of “fair” profits must be purely arbitrary and is based on complete ignorance of how the private-enterprise system works. For it is precisely the *differences* between profit margins that bring about a dynamic balance of production among thousands of different items, that reward efficiency and foresight and penalize inefficiency and poor judgment. To destroy profit differentials, to punish high profits *per se*, is to destroy the productivity foundation of the free-enterprise system.

But even the attempt to take away only the so-called “windfall” profits that accrue as a result of war, desirable as this goal may seem from a moral standpoint, faces formidable practical difficulties. Unfortunately there is no certain way of identifying specifically “war” profits and segregating them from “normal” profits.

The usual method has been to regard the average profits of the three to five years before the war as “normal peacetime profits” and to apply the war-profits tax to any excess above this. What we are really trying to tax in wartime is not the excess of wartime profits over past peacetime profits but the excess over what present

profits would have been if there had been no war. This must at best be guesswork.

It is easy to see how unfair such a standard could be in many cases if applied to the individual income tax. Paul, let's say, had a salary in 1949 of \$5,000. Today he has a better job and a salary of \$7,500. The increase may or may not be the result of the fact that the country is at war. Peter had a salary of \$8,000 in 1949 and has the same salary today. Are we to take Paul's increase of \$2,500 away from him as "war profiteering" or tax it at such a rate that Paul would be paying a higher total tax on his \$7,500 than Peter pays on his \$8,000? Are we to penalize Paul for his \$7,500, simply because he is not *used* to getting that much?

Yet this is the principle that an excess-profits tax applies to corporate earnings—which are merely pooled individual earnings. The presumption that the excess of any particular corporation's earnings today (or in 1951) over those of 1946 to 1949 can be wholly attributed to war or rearmament is no more reliable than in the case of an individual's earnings. The earnings of a new industry, such as television, would in any case have shown a spectacular growth. Even a company now working on direct wartime orders might conceivably have had bigger peacetime orders instead.

An excess-profits tax, in short, rests on a hit-or-miss presumption. And there is a more serious objection to it, especially when the rate is excessive. In the second world war "excess profits" were subject to a tax of 95 percent (with a refund of 10 percent of the tax after the war). This meant that the government took 85 to 95 cents out of every dollar that a company saved by economies, leaving only 15 cents to a nickel of it for the company itself. This all but destroyed the normal incentives for economy and efficiency. It led to inflated expense accounts and caused companies to hoard labor and materials without worrying about costs. In short, it reduced total civilian and war production at the very time when it was most essential to maximize such production.

Under a high excess-profits tax the government loses more on the side of expenditures than it gains on the side of revenues. If we must have an excess-profits tax, let the rate be moderate; and let us get by other means the further revenues we may need. ☼

## 'Full Employment' as Inflation

November 27, 1950

One of the great ironies which future historians will observe about our time is that the American free-enterprise system, which out of its unprecedented

productivity was subsidizing the controlled economies of Europe, was not only being criticized by the recipients of its charity as being ridiculously out of date, but was itself shamefacedly trying to make amends by starting to imitate the very socialistic systems it was having to support.

One is reminded of this situation by an article by Prof. Wilhelm Röpke of Geneva in a new quarterly published in Frankfurt, *Zeitschrift für das Gesamte Kreditwesen*, available in an English translation under the title *The Journal of Finance and Credits*. Dr. Röpke's article exposes the delusions behind a policy of so-called "full employment." His description of this policy as it exists in Europe applies with uncanny accuracy to the American imitation of it:

"The measures envisaged include a continuous reduction of the interest rate; deficit spending; in case of need, large-scale public works financed by the creation of credit; the heaviest of taxation on the classes with higher incomes and great wealth, with the object of restricting savings, which are so much feared; encouragement of demands by the trade unions for increased wages, and so forth."

This policy, which has been pursued by Britain and by nearly every Western European country (with the exception of Belgium, Italy, and Switzerland), puts continuous "full employment" before every other consideration. And its apostles use that phrase to imply that there is no other way to reach their goal except by the inflationary policies just outlined.

"Full employment" is desirable, of course, in the sense that no one wants involuntary unemployment with its consequent loss of income. But "full employment" is not the sole end of human activity. It is not even the primary end. The primary end of economic action is to maximize production. "Full employment" is only a means to the end of maximum production for the satisfaction of human desires. It is one of the central errors of the zealots for "full employment" that they subordinate ends to means.

This initial error is only the first of a chain, and of a series of self-contradictions. It is the "full employment" philosophers who complain most of "chronic private underinvestment." But it is precisely the same group who most vigorously applaud government policies that paralyze the desire to invest. These policies include stiff taxation of successful investment, ruthless exploitation of the monopolistic position of labor unions, special subsidies at the general expense, threats of ever more socialization, currency manipulation of various kinds, a contempt for private property, arbitrariness and an abandonment of all firm economic principles by



governments. Though investment is always directed to an uncertain future, and requires the highest degree of optimism and confidence, all these “full employment” policies make investment more and more of a risk, more and more of a game in which one can lose much but can gain only a little.

The full-employment champions, in short, have no faith in a process of continuous adjustments in conditions of liberty and free competition. The policy they advocate finally results in a continuous competition between a wage policy which seeks to push wages upward, and a credit policy which, to counteract the wage policy, seeks to increase employment.

The upshot of all this, as Dr. Röpke points out, is that the final remedy of the full-employmentists for every trouble is to increase the volume of money and credit. Hence “full employment” tends to result in full inflation. This has to be disguised by repressive measures. And so we get the result of “pent-up” inflation.

Dr. Röpke adds a note. “Full employment” policies, in combination with exchange control, result in Europe in the well-known deficit in the balance of payments. “This policy obviously depends on a foreign benefactor being found.” ❀

## Gray Is for Giveaway

December 4, 1950

When Gordon Gray was asked by the President last March to study our “foreign economic policies and programs,” there was little doubt concerning what his conclusions would be. He was hardly expected to conclude that the Truman Administration’s giveaway program had been a mistake.

The report contains a few sound recommendations such as the reduction of trade barriers and of farm price supports. It even pays brief lip-service to the idea that future civilian loans and grants “should be substantially less than we have been spending.” But it winds up by urging on net balance bigger and broader foreign giveaway programs than ever. And it endorses every fallacy and misconception behind our existing giveaway program. Gray is no serious reexaminist.

There is not space to analyze or even mention all these errors here, but I should like to touch on a few central ones.

1—Like all previous Administration documents of the sort, it ignores the central fact that every dollar we send abroad to increase the productivity of foreign countries must reduce by at least an equal amount the increase in our own productivity. We can push forward

the capital development of foreign countries only by postponing our own. If we donate X dollars for a hydroelectric plant in France we can’t use the same dollars to build a new hydroelectric plant in the United States. Yet the Gray report never once reminds the reader that we cannot give away our cake and have it too.

The notion that America has such a “mature economy” that it cannot profitably absorb any more of its own capital is monstrous nonsense. We could use almost limitless new capital in adding to the quantity and quality of our housing alone.

2—The emphasis of the Gray report is persistently in the wrong place. It doesn’t once recognize and state clearly that the chief obstacle to the capital development of most foreign countries—particularly the much-discussed “underdeveloped areas”—has been their own governmental policies. These policies are hostile to foreign capital—and almost equally hostile to their own domestic capital.

None of the Point Four zealots seem to have stopped to ask themselves the question: If the natural resources are there to be developed, and foreign capital hasn’t yet come in to develop them, why hasn’t it? Private capital goes where it is offered the highest returns or the lowest risks. It goes to the borrowers who most efficiently fill consumers’ needs and have a record of honesty and repayment. That is why private capital tends to provide the most rapid and best balanced world development. Government handout capital, “invested” for political purposes, in the main diverts, distorts, and retards economic development.

3—The Gray report shows no understanding of all this. It even recommends enactment of the bill for “government guarantees of private investment against the risks of non-convertibility and expropriation.” This bill proposes that private foreign investors be allowed to make whatever profit comes from their investment, but that the taxpayers be compelled to pay the losses. Such a proposition has only to be stated plainly to be recognized as preposterous.

Such guarantees, moreover, in effect condone and encourage the very practices they are supposed to insure against. If such government guarantees do not exist, private capital will flow, as it should, only to those countries that have proved by their actions and record—and not merely by offering smooth assurances or signing “investment treaties”—that they will not interfere with currency conversion and will not expropriate property. For contrary to the tacit assumption of the Gray report, no honest or liberal government is compelled to seize foreign investors’ property or to prohibit foreign investors from converting whatever currency they earn into



their own currency—or into any other currency—at the best rates they can get.

There is no room left to analyze the dubious assumptions the Gray report makes about financial military aid to foreign governments. But that can be done at a later time. ❁

## This Is the Peace We Bought

December 11, 1950

Over the past five years, the American public has been repeatedly told by the bureaucrats who were throwing its money all over the globe that they were “buying peace.” Every question was dismissed with the breezy answer: “You can’t expect to buy peace cheaply! What we’re getting for the \$43,000,000,000 we’ve spent on foreign aid since V-J Day is the biggest bargain this country ever bought!” Passing over the question whether peace can in fact ever be bought with dollars, the American people now see, in Korea, just how much peace they got for their foreign-aid money.

I devoted last week’s article to some of the central fallacies behind our foreign civilian giveaway program. Now let’s look at “arms aid.”

We have already given to Western Europe—as we should have done—a guarantee of our military intervention in case it is attacked. This is in itself a tremendous commitment, unprecedented in our history. We also lightly and casually made similar promises in a dozen remote places of the globe. The one to Korea, for example, was considered of such negligible importance that most Americans never heard of or remembered it until June 25. We have already paid a tremendous price for that unweighed promise and still do not know the total price it will cost us to carry it out. Should we start adding still further commitments when we are not sure we can fulfill those already made?

Unless we attach strict conditions, we may only be deceiving ourselves when we transfer foreign aid from civilian to military projects. The mere fact that our funds are “earmarked” for this or that specific purpose is meaningless. If we pay for part of the military programs of Europe, and these programs are no larger than they would have been without our aid, then our dollars or equipment have merely released that much of the European governments’ own funds for other purposes—say for “welfare” programs or to pay the deficit on nationalized industries. Our contribution has not really gone for defense unless these governments spend the whole of it on defense *above the amount they would have spent on defense anyway*. And there is of course

no certain way of determining what this latter figure would have been.

The contention that we must make heavy gifts of money or equipment to Europe for defense is not primarily military but economic. It rests on the assumption that Europe cannot afford to arm itself. (The Gray report, in fact, warns that we mustn’t push Britain to arm too fast, even with our aid, lest it put too much strain on the pound sterling.) The assumption that European nations cannot afford to arm themselves is untenable. What they are arming against, in fact, are nations with incomparably lower living standards than their own. If Communist aggressors divert enough resources to threaten, Europe must divert enough resources to survive.

If we continue to extend foreign arms aid, we must safeguard it with far stricter conditions than in the past. At least three suggest themselves:

1—The nations of Western Europe are in far greater peril from Russian aggression than the United States. Yet they have been spending an average of only 5 percent of their national incomes on defense and an average of only 18 percent of their governmental budgets (as compared with 36 percent in the U.S.). We should insist that most of the countries receiving arms aid devote a far larger percentage of their incomes and governmental budgets to their own defense.

2—As former President Hoover has insisted, we should “say, and at once, that we shall provide no more money until a definitely unified and sufficient European army is in sight.”

3—We should not give any more military (or civilian) funds to any country that fails to send at least token aid in the Korea conflict. The emergency we have been paying to guard against is already here. If these countries are not willing to fight on our side now, we are not justified in giving them more money in the thin hope that they may be fighting on our side in the sweet by-and-by. ❁

## More Inflation Ahead?

December 18, 1950

The first response to the Korean debacle in Washington, in terms of domestic economic policies, was far from encouraging. It was the hasty passage in the House, by an overwhelming vote, of essentially the Administration’s form of the so-called “excess-profits tax.” The only merit of this tax (especially in the form in which it was passed) is that it carries a specious political label that few have courage to stand up against.

The tax itself will hurt, not help, war production. It will breed wastes and extravagances to offset the revenues it ostensibly raises. It will be inflationary compared with any of its alternatives. It will penalize new firms and industries compared with established ones. It will not impose taxes in accordance with present relative incomes but only in accordance with the relationship of these to past incomes. The principle is so bad that practically no one has seriously suggested that it be applied to personal incomes. Yet the income of corporations is merely the pooled income of individuals.

But there has been a note in the recent economic news from Washington that is even more ominous than this. It is the open abandonment of the Administration's previously proclaimed (though never followed) pay-as-you-go tax policy for financing rearmament. Congressmen and Administration officials are now blandly saying that of course it will be impossible to finance war production on the scale now needed except by monetary inflation.

This argument rests ostensibly on the size of the sums now contemplated. The new military appropriation of \$18,000,000,000 for which President Truman has asked would raise total military appropriations to \$49,000,000,000 in the current fiscal year. There is talk of a total budget in the neighborhood of \$75,000,000,000 in the 1952 fiscal year, and Secretary Snyder is already predicting a deficit in that year of \$10,000,000,000 to \$15,000,000,000.

The politicians who think that monetary inflation is now either "unavoidable" or preferable to its alternatives simply do not know what inflation is or what it does. Inflation is not a way of avoiding taxation; it is itself a form of taxation. It is tantamount to a huge sales tax on all commodities, with the rate as high on bread and milk as on jewelry and furs. It is equivalent to a flat unprogressive income tax, without exemptions, on rich and poor alike. It is a flat unprogressive capital levy on all savings accounts, life insurance, government bonds.

And yet those who are blandly proposing this are the very people who still fight tooth and nail against the merest suggestion of a more broadly based income tax, or of excise, sales or expenditure taxes, and who pretend that they want to tax only "the rich" or "the war profiteers." They favor inflation because it disguises the realities (perhaps as much for them as for its other victims) under endless illusions.

Given a certain maximum production, the civilian population, the consumers, must be deprived of whatever production or consumption is diverted to the war effort. When this is done through honest and outright

taxation, taxes take away the same amount of money from the consumer that they turn over to the government. When it is done through monetary inflation, the consumers' real deprivation is not lessened in the slightest degree. Its incidence is merely far more haphazard and unfair. The average citizen's nominally higher income is far more than offset by higher living costs. The government too is deceiving itself, for it must spend far more money for the same war preparedness.

In the long run, inflation only increases the real deprivation of the taxpayer. It draws attention away from the government's failure to slash needless expenditures—which Senator Byrd has estimated at \$10,000,000,000. It leads to a demand for price and wage controls, which cannot offset the inflation but merely abridge economic liberties while they reduce, distort, and disrupt production.

There is no magic in inflation except the magic of self-deception. It leads in the end to chaos and collapse. ❁

## Total Muddleization

December 25, 1950

The President's proclamation of a "national emergency," however well intended, is a rhetorical gesture that creates more problems than it solves. It will not of itself produce a single additional gun, tank, or plane. It serves no other purpose than to give more powers to an Administration that has not known how to use the huge powers it already had. It was not needed to "arouse" a country already more aroused than Washington.

The phrase "total mobilization" is also a rhetorical solution based on a false analogy. "Mobilization" has hitherto meant the actual assembly of armies for war. It is now being used metaphorically to mean the imposition of rationing, price fixing, and wage fixing. Such controls do not "mobilize" anything. They reduce, unbalance, and disrupt production, and tie the economy up in bureaucratic red tape.

We have once more stumbled into price control by a chain of blunders and bad thinking. On Dec. 7, Alan Valentine, Administrator of the Economic Stabilization Agency, asked Ford and General Motors to rescind the price increases on their 1951 passenger automobiles until his agency could examine and determine "the entire question of price." Both refused. Henry Ford II pointed out that the proposal was discriminatory. General Motors pointed out that its new prices were less than 5 percent over its pre-Korean-war prices, though

the increase in its wages and raw-material prices had ranged from 7 to 300 percent, and "no stabilizing action has been taken regarding the prices of these materials."

These replies were good as far as they went. But they did not point out that the chief cause of inflation was the government's own spending, deficit, and monetary policies. Nor did they emphasize the absurdity of "fighting inflation" by beginning with automobile prices. Here was a government which was not only failing to hold down food prices, but was still deliberately boosting food prices, not only through monetary inflation but by creating artificial shortages and "supporting" the prices of eggs and potatoes. And its first concern was not to reverse these food policies but to protect the poor from paying too much for Lincolns and Cadillacs!

Government price control is inevitably political, and such absurdities are not accidental but systematic. Politicians are afraid to hold down wages for fear of losing the labor vote. They are afraid to hold down food prices for fear of losing the farm vote. They will hold down rents, in war or peace, because the tenant vote is bigger than the landlord vote. And "the big automobile companies" are of course easy political targets. It is naïve to put the power to fix prices in the hands of

politicians and expect that power not to be used as a discriminatory political weapon.

But even if the Bernard Baruch dream of completely "nonpolitical" price control could be realized, it would still be harmful economically. The "selective" price control that Mr. Truman wishes to begin with must lead inevitably into overall price control. And overall price ceilings must *unbalance and disrupt production*.

Price control never offsets inflation; it increases it. It directly discourages production, encourages consumption, and intensifies shortages. It helps to lull the public until too late into believing that "inflation" is being "controlled." It draws public attention away from the real cause of inflation, which is the government's own creation of more money and credit. If the public can be led to believe that the culprits are private "profiteers," then it will not demand the reduction of wasteful public spending, the termination of bond-pegging, the increase in interest rates, and the overall control of credit which are the only real cures for inflation.

Politically, President Truman's radio address was conciliatory in tone and in parts courageous. He was sincerely trying to act in the national interest. But his proposed economic program can only lead on net balance into muddle and disorganization. ❀

**1951**





## The Price-Control Straitjacket

January 1, 1951

The proclamation of a “national emergency,” followed by the immediate imposition of price control, was a double misfortune and a double diversion. It diverted public attention away from our military defeat in Korea, and even from our foreign policy in general, to internal controls. And it diverted public attention away from the sole cause of inflation—the government’s own money and credit policies—to a false and irrelevant remedy built on a false diagnosis.

Price fixing is not even a partial or a supplementary remedy for inflation. It is not a remedy at all. If the volume of money and credit is kept from expanding, there is no need for price control. If the volume of money and credit is recklessly encouraged to expand, price control is worse than futile. It must merely unbalance and disrupt production.

But these basic facts are still not understood in Washington—not in the White House, not in the Treasury, not by most members of Congress. And so our economy is being snarled in the red tape of price control.

There cannot be such a thing as intelligent price control. Price control is unsound in principle. Yet the theory today seems to be that the reason the OPA made a mess of things is that the Hendersons and Bowleses and Porters did not know what they were doing. It is true that they did not know what they were doing, but it is also true that they were being asked to do something that not even geniuses or archangels could do well.

Our present price controllers have begun, not by trying to hold down the price of foodstuffs (of, say, bread or milk) but by rolling back the price of—automobiles! They have announced cloudy, confused, and obviously unworkable overall “voluntary” and “honor system” standards for price ceilings. These are certain to break down. This will then “oblige” the controllers to impose their threatened mandatory price ceilings.

The controllers did not dare to announce parallel wage standards. The union bosses, who had at first demanded price control without wage control, suddenly switched tactics and demanded “wage stabilization” standards which were in fact wage-boosting.

But government price control is inevitably political, and perhaps even present discriminations are no more flagrant than in the past. “At the moment of writing this [I wrote in *Newsweek* of Oct. 28, 1946] our whole price-control system is a mass of fantastic contradictions. The price of whisky is controlled, but the price of milk is not. Lamb prices go where the market sends

them; but automobiles are held down by government edict so that the poor can buy their share of Lincolns and Cadillacs.”

Present discriminations do not prove, however, that Bernard Baruch’s dream of “an overall ceiling across the entire economy,” made nondiscriminatory by a rollback or freeze of all prices and wages as of June 25, would have been any better economically even if it had been politically possible. For the advocates of both selective and overall price ceilings overlook the function of free prices, which is to maximize and balance production continuously in accordance with today’s, not yesterday’s, supply and demand. Only free markets can balance and synchronize the relative production of thousands of different commodities, and bring the quickest conversion to production of war goods.

The worst feature of price control is that it concentrates public attention on a false remedy which can only put the economy in a straitjacket, and divert attention from the remedies that really need to be applied. It is the very government that pretends to be “protecting” us against “inflation” by price controls that is causing the inflation by its monetary and credit policies—by unbalanced budgets, bad taxation, wasteful spending, and by holding down interest rates and monetizing the public debt.

And because these elementary things are still not understood, we are returning, on an even greater and more dangerous scale, to all the errors of the past. ❁

## How to Stop Inflation

January 8, 1951

Overnight, without any serious consideration of past experience, present facts, theory, or consequences, the economy has been put into the straitjacket of price control. This has happened because most people still do not understand that price control creates far more problems than it “solves.” It has happened because, in spite of the Niagara of books, pamphlets and editorials in the last ten years, most people still do not understand what inflation really is, what causes it, and what can cure it.

Fortunately, the problem of inflation is in at least some respects much simpler than it is commonly thought to be. There are not a hundred different causes. There is only one: an increase in the volume of money and credit in relation to the volume of goods. When people have more dollars to bid for the same supply of goods, they will bid prices up. Putting the matter another way: just as each individual bushel of wheat will exchange for less, other things being equal, when the

supply of wheat is increased, so each individual dollar will exchange for less, other things being equal, when the supply of dollars is increased.

At the end of 1939 the combined total of demand deposits and currency outside banks was \$36,194,000,000. At the end of May of 1950 it was \$109,700,000,000. In other words, the supply of money in the pockets and bank accounts of consumers and other buyers had more than tripled.

It was said and commonly believed in the second world war that prices were high because of the "shortage of goods." This was not true then, and it was certainly not true after the war, when prices went higher still. The cost of living right at the end of the second world war, in August 1945, was 29.3 percent above the 1935–39 level; the cost of living in May 1950 was 68.6 percent above that level. The wholesale price index rose from 105.7 in August 1945 to 155.9 in May of 1950. This was certainly not because goods were scarcer in May of 1950 than during the war or in the prewar period. On the contrary, the official index of industrial production in May of 1950 was 95 percent higher than in the prewar period 1935–39.

Why were prices so much higher in spite of the fact that goods were so much more abundant? The answer lies in the volume of currency and demand deposits, which was not only three times as high in May of 1950 as in the 1935–39 period, but \$12,000,000,000 higher than at the end of July of 1945.

A similar explanation must be given for the rise in prices since the outbreak of war in Korea. It is not due to a greater "shortage of goods." The index of industrial production, in fact, has risen from 195 in May to 214 in November. But in that period there has also been an increase of some \$5,000,000,000 in demand deposits. The secret of the rise in prices, in other words, is that more money has come into existence to buy even the increased supply of goods.

Even sophisticated bankers and economists get confused about this subject because the causation often *seems* to be the other way round. It is not always the increase in the money and credit supply that comes before the rise in prices. Often (and this happened after the outbreak of the Korean war) it is the price rise that comes first. But what most people overlook is that unless an increase in money and credit followed immediately, the price rise could not be sustained.

A typical chain of causation is this. War breaks out. Manufacturers and speculators think that the demand for certain goods is going to increase, making them higher in price. Therefore they begin to buy and hold them immediately. But to buy and hold them *at a higher*

*price* they need more credit. This is usually forthcoming from the banks as a matter of course. If the banks *refused* this credit, however, or were not allowed to expand their total volume of advances, or if interest rates were raised to a point that discouraged this further expansion, no substantial *general* rise in prices could be sustained. The rise in the price of war goods would be offset by declines in other commodities.

Inflation is a monetary and credit phenomenon—and nothing else. ❁

## Inflation Has One Cure

January 15, 1951

On Dec. 28 the Federal Reserve Board announced increases in the legal reserve requirements for the 6,900 member banks of the Federal Reserve System as a measure to curb credit. The increases, to be spaced out over the period from Jan. 11 to Feb. 1, took the form of a rise of 2 percentage points in demand deposits and 1 percentage point in time deposits. The board explained that the effect of this measure would be to raise required reserves by member banks by about \$2,000,000,000, and that this would make unavailable about \$12,000,000,000 in potential bank credit.

It must be said in favor of this measure that it seeks to curb inflation in the only field in which it really can be curbed—that of monetary and credit policy. But it must be added in all candor that this step is wholly inadequate in itself, that it is little more than a token measure, and that even its small effects will be and are being offset by inflationary countermeasures on the part of the Federal Reserve authorities themselves.

As the National City Bank of New York points out in its January monthly bank letter: "As the reserve requirement increase was announced, there was evidence in the market that the Federal Reserve Banks had again put pegs under the government security market to maintain their price levels. . . . For most of the banks, doubtless, the adjustment will be accomplished with the greatest mechanical facility. Government securities will be sold with the Federal Reserve the buyer. In effect, banks will ship a part of their government securities to the Federal Reserve where they will get a credit of idle, unusable cash. By and large, the whole of the operation—increasing cash reserve requirements with one hand and supplying the cash with the other—is self-defeating. . . .

"Pegs, rigidly maintained, invite any and all holders of marketable government securities to turn their holdings into cash, for spending or lending, any time they

please. Those holdings, outside the Federal Reserve Banks and Treasury investment accounts, run to \$130,000,000,000."

Monetary authorities have long recognized that changing cash reserve requirements is at best a supplementary—and an awkward—method of credit control. But if it is resorted to at all, it should certainly not be used in the disingenuous and self-defeating way in which the Federal Reserve authorities are now using it. What is sauce for the goose must be sauce for the gander. Whenever the reserve requirements of the member banks are raised, the reserve requirements of the Federal Reserve Banks ought also to be raised. The latter's reserve requirements used to be 35 percent against deposits and 40 percent against notes. But under the Reserve authorities' plea of emergency they were lowered by Congress in 1945 to a uniform reserve requirement of only 25 percent.

The most direct and immediate way in which Congress could put the country on notice that it is determined to prevent inflation, and knows the direction in which the danger really lies, would be to restore the former reserve requirements of the Federal Reserve Banks themselves. It should, in addition, give the Federal Reserve Board discretionary authority to raise even such requirements, just as it already has discretionary authority to raise requirements of member banks. And if Congress also allows the board discretionary authority to let a Federal Reserve Bank's reserves fall below, say, 40 percent, it should only be with the proviso that such a bank cannot increase the net volume of its investments and advances as long as its reserves are below that ratio.

But even such legal requirements, though important, would be chiefly symbolic and supplementary. Nothing can take the place of proper credit policy on the part of the Federal Reserve authorities themselves. As Governor Eccles of the Federal Reserve Board said a year ago: "In making a cheap money market for the Treasury, we cannot avoid making it for everybody. All monetary and credit restraints are gone under such conditions; the Federal Reserve becomes simply an engine of inflation." ❁

## Mr. Truman's Wrong Remedies

January 22, 1951

President Truman's tremendous economic demands on this country, in his State of the Union message to Congress, are so closely related to his foreign policy that it is difficult to discuss them purely on their own merits.

Mr. Truman chooses to ignore the fact (pointed out by Mr. Hoover) that this country is already bearing an altogether disproportionate share of the burden of the collective defense of the 53 "democracies." What the President now proposes, in effect, is that we assume an even more disproportionate share of that burden.

Even today, for example, Mr. Truman blandly recommends that we continue the Point Four program. Our government is to "help people who are striving to advance from misery, poverty and hunger"—all over the world. And it is to do this by forcing the American taxpayers to drop still more money into "underdeveloped" countries so that their governments will not have to make the reforms necessary to attract private capital, either domestic or foreign. The Point Four program not only puts an added strain on our own economy; it *retards* world production. It bypasses the prods and incentives of free enterprise to substitute the principle of the free lunch.

Mr. Truman lists ten subjects "on which legislation will be needed." These include still bigger appropriations and still higher taxes—but not government economy. As an afterthought, however, he declares that the government "must practice rigid economy in its non-defense activities."

Unfortunately, too much weight cannot be attached to this single sentence of lip-service. Mr. Truman has been making similar declarations over a long time now, yet on net balance the very opposite continues to happen. It is to be observed, further, that in this message Mr. Truman did not specify just what nondefense expenditures were to be cut. He did specify, on the other hand, many non-defense expenditures that were *not* to be cut. He even spoke of "rounding out," "improving," and adding—in other words, of making bigger—social insurance, old-age pensions, unemployment benefits, government health insurance and socialized medicine.

Mr. Truman asked for "improvement of our labor laws" to increase production in the emergency. If taken seriously, this proposal would mean the suspension of the present legal penalty rate on all weekly working hours above 40. He asked for "improvement of our agricultural laws, to help obtain the kinds of farm products we need for the defense effort." By far the best way to do that would be to repeal all our "parity," control, and subsidy laws and let the supply and kinds of farm products be determined by demand through free prices.

Mr. Truman asked for "revision and extension of the authority to expand production and to stabilize prices, wages, and rents." Congress should not extend this authority but contract it. If Congress could force the Administration to abandon its policies of monetary



inflation, none of these price-fixing powers would be needed.

To quote from a statement by the Committee for Economic Development on "Paying for Defense":

"Experience in the United States and in other countries has demonstrated that this [a system of general price and wage controls and rationing] is not an effective solution to the inflation problem, especially if the problem lasts for a long time. Even while the controls are nominally in effect, price increases break through in black markets, in deterioration of quality, and in the disappearance of low-priced goods from the market. Price ceilings and wage rates come to be determined in a political bargaining process which pushes up the prices and incomes of the groups most powerful politically at the expense of those less powerful. And when the controls finally come to an end, either by formal decision or by erosion in fact, the dammed-up inflationary pressure breaks out in open inflation. [Meanwhile] prices are prevented from performing their economic function of directing production . . . and economizing the use of scarce resources." ☼

## An Irresponsible Budget

January 29, 1951

Senator Byrd was using the language of restraint when he declared that President Truman's budget of \$71,000,000,000 for the next fiscal year was "the very height of fiscal irresponsibility." Mr. Truman no longer seems to attach any meaning to figures, or even to pledges. He has repeatedly promised "rigid economy in nondefense activities." And he solemnly continues his lip-service to "strict economy" in the very budget in which, as Senator Byrd points out, proposed nondefense spending is increased "to the highest level in the history of the nation."

Mr. Truman threw in practically the whole Fair Deal spending program—compulsory health insurance, bigger unemployment benefits, Federal subsidies to education, including nursery schools, more public power projects, including the St. Lawrence Seaway, more government housing, more handouts to foreign countries for "economic recovery," and on top of all this, the Brannan farm plan, the year-to-year cost of which is indeterminable.

It may be doubted whether Mr. Truman seriously intended this as a budget or meant it only as a campaign document—so that, in 1952, he can tell the pressure groups that he asked for everything, and only a niggardly Congress denied it.

The response of Congress to this budget was much milder than it should have been. Senator Byrd's estimate that it could be sliced by \$7,000,000,000 was very moderate. Representative Taber's contention that it could be cut by \$4,000,000,000 was even more so. I hazard the guess that with proper Federal policies and proper administration of spending, the whole \$16,000,000,000 difference between the proposed \$71,000,000,000 of spending and the \$55,000,000,000 of prospective tax yields could be cut, making it possible to balance the budget without increasing taxes any further. And the result could be both more production and better defense.

Mr. Truman still talks of government expenditures as if they came out of some fourth dimension, and bought more things than were bought before. All they do is to change the *direction* of spending. What the government pays out to Paul it must take from Peter. What it spends on government project X it must take away from unborn or unexpanded private projects Y and Z. For every speech Mr. Truman makes on how many "new needs" he is meeting by his \$71,000,000,000 of expenditures, millions of mute inglorious taxpayers could make a speech on how many old and new needs they will be unable to meet because these billions will be taken away from them.

It is not enough for government to prove (though it seldom attempts even this) that every dollar it spends meets some vague "need" or other; it must show that every dollar it spends meets a *greater* need than it would have met if the man who earned it had been allowed to spend it on his own family or for his own projects.

Nor should we allow the magic word "defense" to save a proposed expenditure from serious scrutiny. Once Congress permits the Administration to set up a sacred and untouchable category of expenditures, it will find the Administration shoving every proposed expenditure possible under that category. Today "defense" covers a multitude of fiscal sins.

If there is any fiscal responsibility in Congress itself, it will return Mr. Truman's 1952 budget to him without approval, and request him to submit a responsible, balanced budget with a certain specified number of billions sliced off the expenditure side. It will bind itself, in return, not to increase by its own appropriations either the total or any individual item of this revised budget. But it will not bind itself not to make any further *reductions* in individual items when the individual appropriation bills come before it. And its separate committees—including the Armed Services and Military Affairs Committees—will increase their technical and

research staffs and make a far less perfunctory scrutiny of expenditure requests than they have in the past. ❁

## Fighting Fire with Gasoline

February 5, 1951

How preposterous can the situation get? The Administration starts the inflationary fire, fights it by pouring on more gasoline, and then talks as if it were completely mysterious in origin. Or it hints that the fire was started by business, by the “speculators,” the “hoarders,” the “profiteers,” or by the buying public. And it acts on this assumption when it insists on the completely false remedy of price control, which puts the economy in a straitjacket of prohibitions, allocations, rationing, licenses, and subsidies, unbalances and disrupts production, creating artificial shortages. All this is called total mobilization.

Take the Secretary of the Treasury, John W. Snyder. He is personally a mild-mannered, quiet, unassuming, amiable, loyal, and honorable man who thinks of himself as a conservative. He would be shocked beyond measure to learn that he is more responsible than any other single man for the existing inflation in this country and the almost universal fear of further inflation. And he has earned this No. 1 position not only by his past record but by his extraordinary announcement on Jan. 18 that the long-term rate for marketable Federal securities must be held to 2½ percent. He might just as well have announced outright that he is determined to have more inflation.

Mr. Snyder's attitude stems, of course, not from any desire for inflation, but from a tragic lack of understanding of economic cause and effect. Inflation, always and everywhere, has one basic cause—an increase in the supply of money and bank credit. At the end of 1939, demand deposits and currency outside of banks totaled \$36,000,000,000. At the end of May of 1950 this total had reached \$109,000,000,000. At the end of December of 1950 it had reached \$117,000,000,000. This is not merely the *cause* of inflation; this *is* the inflation. The increase in commodity prices is merely a consequence.

And the principal cause in turn of this increase in money and bank credit has been the artificially low interest rates maintained by the Treasury.

This cheap money policy has not merely swollen the volume of private borrowing; it could be maintained—in connection with the policy of pegging government bonds above par—only by encouraging the member banks to load up with government bonds and by forcing

the Federal Reserve Banks to buy as many of those bonds as is necessary to maintain the predetermined rate. They bought these bonds by creating deposits or printing money.

All this is now an old story among monetary economists and bankers. But Mr. Snyder has never understood it. He can see the problem only from the immediate short-run interest of the Treasury—to pay as low an interest rate as possible. “Any increase in the 2½ percent rate,” he says “would seriously upset the existing security markets.”

Any increase in prevailing interest rates would of course mean a lower price for present outstanding bonds. But Mr. Snyder refuses to see that the only alternative to accepting this comparatively mild consequence is an uncontrollable inflation. In the face of overwhelming economic opinion and evidence to the contrary, Mr. Snyder persists in declaring that a cheap money policy and inflation have nothing to do with each other.

If Mr. Snyder stood alone in this appalling blindness the situation would not be so grave. But he is supported in Administration circles by a conspiracy of silence. Within the Federal Reserve System there is some real understanding of the situation; but—with a few honorable exceptions like Allan Sproul, president of the Federal Reserve Bank of New York—there is precious little courage. Mr. Snyder's statement clearly implies that Chairman McCabe of the Federal Reserve Board acquiesces in the policy of maintaining the inflationary 2½ percent interest rate. In lieu of any genuinely effective overall action, the board on Jan. 16 announced the token gesture of increasing required stock margins from 50 to 75 percent. Meanwhile, an ominously growing bureau prepares to “cure” inflation with the colossal hoax of price control. ❁

## Price Control Means Politics

February 12, 1951

The confusion at Washington has reached such a point that even the price controllers admit that they don't know what they're doing. They announced the so-called overall price-and-wage freeze on Jan. 26. The very next day an executive of the Office of Price Stabilization said that his agency was working intensely to “cure the absurdities and inequities inherent in such a sweeping order.” How many times this order will be changed or amended no one can predict. But what can be predicted with complete confidence is that no matter how many times the order is changed or amended it will still be riddled with “absurdities and inequities.”

Those who, like Bernard Baruch, honestly believe in what they call “an overall ceiling across the entire economy,” assume that the nondiscriminatory and non-political way in which this could be done would be to freeze all prices, wages, rents, fees, and so on as of a particular date. Mr. Baruch originally recommended June 25, the day hostilities broke out in Korea.

This proposal—or a proposal to take the prices of any other date or period as the basis for an overall freeze—has fatal defects. It treats the prices or price relationships of that date as peculiarly “normal,” “fair,” or “right.” But the general price level of that date reflects the money supply of that date; and the specific prices and price relationships reflect the individual state of supply and demand for each commodity on that date. Even if we disregard changes in the supply of money and credit, the commodity supply-and-demand relationships of yesterday are never those of today.

The function of free prices, free wages, and free markets is to direct production into the goods that are most needed and away from the goods that are least needed; to balance and synchronize production as among thousands of different commodities; to bring about a voluntary allocation of land, capital, and labor to their most efficient and productive uses.

Even an honest overall price-and-wage ceiling, therefore, would deprive us of the invaluable guidance that free prices give. It would misdirect and waste capital, labor, and other productive resources. It would cause both hardships and wastes in consumption. It would disrupt productive relationships and bring on artificial bottlenecks and shortages. But what we are getting is a dishonest “overall” price-and-wage ceiling, which is much worse. It is riddled with special exemptions and discriminations. It exempts farm prices under “parity.” It tries to free the farmer while controlling the processor and distributor. It treats wages quite differently from industrial prices. It holds some prices at the peak and “rolls back” some others. It is going to straighten out “inequities”—which means, as experience shows, that it is going to hand out political favors and penalties. Our price control, in brief, is saturated with politics.

Nor is the politics going to be taken out. Political favoritism is inevitable in government price control. The appointed price controllers are not solely to blame. They have to deal, for example, with discriminations already built into the law. Our farm-price-parity laws and labor laws are full of built-in inflationary pressures.

Price fixing does not merely put huge economic power, always abused, into the hands of politicians, but it serves to divert public attention away from the fact

that it is the government itself that creates the inflation from which it then “protects” the citizens. At the very moment when the government resorts to the fraudulent remedy of a general price freeze, President Truman openly supports Secretary Snyder’s announcement that the rate on long-term government bonds must be kept pegged at 2½ percent. As Governor Eccles of the Federal Reserve Board has pointed out, this can only be continued “by the creation of tremendous sums of money, at the cost of progressive decline in the value of the dollar.”

No serious effort to stop inflation is possible until the government halts this government bond-pegging policy. ❁

## Inflation Plus Usurpation

February 19, 1951

On Jan. 31, at a meeting that should never have been called, President Truman presumed to lecture the Open Market Committee of the Federal Reserve System on what its policies ought to be in the present crisis. The next day the White House Press Secretary announced: “The Federal Reserve Board has pledged its support to President Truman to maintain the stability of government securities as long as the emergency lasts.” Then Mr. Truman made public a “Dear Tom” letter to Chairman McCabe of the Federal Reserve Board in which he thanked him for “your assurance that the market on government securities will be stabilized and maintained at present levels.”

Governor Eccles of the Federal Reserve Board was “astonished” by the President’s version, denied flatly that the agency had given any such pledge, and made public the board’s own memorandum covering what took place. The memorandum failed to support Mr. Truman’s version.

We need not be diverted by any attempt to appraise the comparative accuracy of these conflicting versions. If we keep our eye on the legal and economic issues involved, it is clear that Mr. Truman is wrong on both.

The President has no more legal right to tell the Federal Reserve Board what to decide than he has to tell the Supreme Court what to decide. To minimize Presidential influence, Congress deliberately made the board an independent body, with fourteen-year terms for each of the seven members, overlapping so that no President should have the appointment of more than one member in any two-year period. The late Senator Glass long ago quoted President Wilson as saying: “The very moment that I should attempt to establish



close relations with the [Federal Reserve] board, that moment I would be accused of trying to bring political pressure to bear." The pressure that Mr. Truman is now bringing to bear on the board is a clear usurpation of power.

President Truman and Secretary Snyder are patriotic and sincere. They simply do not understand the economic consequences of what they are proposing. They wish to force the Federal Reserve Banks to keep buying as many government bonds as necessary to hold them above par, and so keep down the long-term yield to the arbitrary maximum of 2½ percent. Now when the Reserve banks buy such government bonds they pay for them simply by creating deposit credits or printing money in exchange. These in turn become the reserve bases for member banks to create still more money and bank deposits. This creation of more money and bank credit without more goods is not merely the cause of inflation; it is the inflation. Mr. Truman and Secretary Snyder might just as well tell the Federal Reserve Board point blank: "We demand more inflation!"

None of the reasons that either Mr. Truman or Mr. Snyder gives for wanting Federal bonds pegged at par or over will stand examination. Mr. Truman recalled before the Open Market Committee "his wartime experience when he bought Liberty bonds out of his soldier's pay. When he returned from France and had to sell his bonds to buy clothes and other civilian things, he got only \$80 or a little more for his hundred dollar bonds. . . . He did not want the people who hold our bonds now to have done to them what was done to him."

Now none of the Liberty bonds ever fell quite as low as 80. Some issues did fall within a few points of that price, but only for a few months in 1920. And the decline affected only those people who were forced to sell in those months. The maximum loss even of these people was only about 18 percent. Today, on the other hand, mainly as a result of the very bond-pegging and low-interest policies on which Mr. Truman has insisted, a government bond bought in 1942 has a purchasing power in terms of consumer prices of only 70 percent of what it had then. This is a real depreciation of 30 percent. Which policy—that of the first or the second world war—was worse for the bondholders? ❁

## Abolish the RFC

February 26, 1951

In the Feb. 19 *Newsweek* Raymond Moley dealt with the scandals that have developed in the Reconstruction Finance Corp.; but in the light of subsequent

developments and of the wider issues involved, some further comment seems warranted here.

On Feb. 2 an investigating panel of the Senate Banking Committee, after months of inquiry, brought in a report charging improper use of the RFC's lending authority, political and personal favoritism, and mismanagement. It was the practice of one director, the report found, "to give special attention to matters in which the [Democratic National] Committee was interested." Other details, including the remarkable rise of an E. Merl Young, husband of a secretary to one of President Truman's secretaries, from a \$1,080-a-year messenger job, to a vice presidency of the Lustron Corp. (an RFC borrower) at \$18,000 a year, and finally to an income of \$60,000 in 1950, were recorded by Raymond Moley last week.

Though these factual findings were unanimously approved by the subcommittee, consisting of two Republican and four Democratic senators, Mr. Truman at a press conference dismissed the report as asinine. He followed this up by defiantly sending to the Senate the nominations of all five directors of the RFC—even though the last session of Congress had declined to take action on these nominations, and though three of the nominees were named by the Senate subcommittee report as having been unduly influenced in the grant of loans by individuals close to the President.

The subcommittee, however, apparently thinks that it would remove the political element from the RFC's loans if the five-man board of directors were replaced by a single governor with complete responsibility. The blunt truth is that there is no cure short of the abolition of the RFC itself.

The RFC was set up in 1932 to perform a specific emergency function—to make loans to banks then under pressure, against sound assets which were not legal for rediscount at the Federal Reserve Banks. Once this emergency function was performed the RFC should have been liquidated.

On the contrary, it was not only retained but expanded, and was soon used for making direct loans to business. Such loans were bound to be economically unsound. A solvent and promising business, willing to pay the going rate for money, can obtain it from private lending institutions. Therefore, the firms that turn to the RFC for money must be either those who are unwilling to pay the going rate (already kept unsoundly low by the government's cheap money policy) or those firms whose credit and prospects are not good enough to satisfy private lending institutions. The RFC, in fact, exists on the self-contradictory assumption that there are loans sound enough to risk the American taxpayer's



money in, though they are not sound enough for any private individual or institution to be willing to risk its own money in.

The \$37,500,000 loan made by the RFC to the Lustron Corp, is typical of what happens under such an assumption. According to some estimates, the RFC will be lucky to get back 5 cents on the dollar from that "investment."

It is argued that the RFC cannot be abolished now because it is needed to make "defense" loans to private business. This argument is without substance. Any solvent, well-managed corporation with a government contract in its hands should have no trouble in borrowing from private banks all the money it needs to fulfill that contract. But if we create a system under which private persons can get the funds from one government agency to set up facilities to solicit contracts from another government agency, we have created still further opportunities for political pressure and corruption. Even as matters already stood, as the Hoover Commission warned in a report on March 31, 1949: "Direct lending by the government to persons or enterprises opens up dangerous possibilities of waste and favoritism to individuals or enterprises." The RFC should be abolished. ☸

## How to Cause a Famine

March 5, 1951

"This program," said President Truman, in asking Congress to give the Indian Government 75,000,000 bushels of grain, "does not constitute a precedent for continuing to provide food to India on a grant basis or for providing similar aid for other countries." But it does, of course, constitute precisely such a precedent. We cannot do less in future for India or any other country without being accused of less generosity or plain discrimination.

Famine and starvation should, of course, always be prevented or relieved when humanly possible. But we must also ask what caused it, whose duty it is to relieve it, and what steps are essential to prevent its recurrence.

It has gradually, precedent by precedent, become the assumption of most foreigners and most American Fair Dealers that when any real or imagined deficiency of anything whatever exists anywhere on earth, it must be made good primarily, if not solely, at the expense of the American taxpayer. Yet even the Indian Government did not ask us for more than a long-term loan to enable it to buy this grain. Given reasonable

prudence, it could easily have repaid such a loan. Why did Mr. Truman recommend a gift?

The process will be this. "America" will give the grain. But the average Indian (nearly 85 percent of the Indian people are illiterate) will probably never know this. For the gift will be to the Nehru *government*, and the Nehru government will *sell* the grain to India's hungry. Moreover, the Nehru government will be allowed to keep for statist schemes even the "counterpart funds" it gets for selling what we give.

Just as Mr. Truman ascribed the Yugoslavian food shortage solely to "the drought," so he now ascribes the Indian famine solely to "natural disasters—earthquakes, floods, droughts, and plagues of locusts." Yet the famine has at least been intensified, if not principally caused, by the economic policies of the Nehru government:

1—The Nehru government is a "planning" government, a socialist government. Like all such governments it has embarked on a grandiose "industrialization" program. This means that it has diverted land, labor, and capital from agricultural to industrial production. This has directly reduced India's production of food. Mr. Truman apparently approves of this compulsory diversion. For he wants to compel American taxpayers to subsidize it. It is explicitly because he wishes the Nehru government to have the funds to continue this "long-range economic development program" that he thinks American and not Indian taxpayers should be asked to pay for the present Indian food deficiency.

2—Specifically, the Nehru government intensified India's food shortage by its isolationist efforts to become independent of Pakistan (or anywhere else) for cotton and jute. It *ordered* a reduction in grain-growing acreage to increase cotton and jute acreage.

3—The Nehru government has not permitted free markets in agriculture. It has put price ceilings on grain. These have, as always, discouraged and reduced the production and sale of grain. The government has resorted to forced government procurement of grain from peasant growers. Our government is asking American taxpayers to suffer from these policies and is not suggesting any change in them. Therefore the food shortage is likely to recur.

4—The argument that India cannot pay \$190,000,000 for grain because it has only "limited foreign exchange reserves" and an "unfavorable balance of payments" is economic nonsense. These conditions are the result of the Nehru government's own exchange control measures. It has made dollars scarce in the same way as it has made foodstuffs scarce—by putting artificial price ceilings on them.

In this grain discussion the whole emphasis has been on distribution. But in the long run nothing can save India or the world from poverty and famine but greater production. And there is willful blindness to the fact that government “planning,” price-fixing, and socialism inevitably discourage, reduce, and disrupt production. ❁

## Inflation Is Government-Made

March 12, 1951

The Treasury’s announcement that it will offer “non-marketable” bonds bearing  $2\frac{3}{4}$  percent in exchange for issues of its outstanding  $2\frac{1}{2}$  percent bonds maturing in 1967–72 must be warmly welcomed as at least a step in the right direction and the first crack in the  $2\frac{1}{2}$  percent fetish.

The sole cause of inflation is an increase in volume of money and credit in relation to volume of goods. This has gone steadily forward. At the end of 1939, both demand deposits and currency outside of banks totaled \$36,000,000,000. Wholesale prices in 1939 stood at an index number of 77. At the end of May 1950, money-and-credit volume had increased to \$109,000,000,000. Wholesale prices in May 1950, had risen to an average of 156. In December 1950, money-and-credit volume had reached a total of \$118,000,000,000. Wholesale prices had soared to an average of 175.

This general rise of prices cannot be attributed to any general “shortage of goods.” On the contrary, the index of industrial production, which stood at 109 in 1939, had risen by May of 1950 to 195 and by December to 216. This rise in production was the chief reason, in fact, why wholesale prices between 1939 and the end of 1950 did not rise more than 127 percent, though the volume of money and bank credit increased by 228 percent.

The chief cause for the increase in the volume of money and credit all through this period was the government’s own cheap-money policy, maintained mainly through the device of pegging outstanding government bonds above par. The Federal Reserve Banks were forced to buy the bonds, which were then made the basis for the creation of more money and credit. At the end of 1939 Federal Reserve Banks held \$2,484,000,000 of U.S. Government obligations and the commercial banks \$16,316,000,000 worth. At the end of 1950 Federal Reserve Banks held \$20,800,000,000 worth and the commercial banks \$62,390,000,000 worth. Thus a total of \$83,196,000,000 out of the whole increase of \$82,000,000,000 in money and bank credit since the end of 1939 in effect represents the “monetization” of

government securities acquired by the nation’s banking system.

Mr. Truman’s memorandum of Feb. 26 on government debt and general credit policies wrongly identified “stability” of government securities with “full confidence in the public credit,” and this in turn with an artificial parity. Yet obviously the government cannot create real confidence in its own credit by forcing its left hand to buy the bonds that it “sells” with its right. It has managed to keep up the nominal quotation of the bonds only by a process that has led since 1939 to a depreciation in their real purchasing power of 44 percent. In a self-defeating effort to prevent further inflation, while still preserving the fetish of a  $2\frac{1}{2}$  percent long-term interest rate for government securities, the President’s memorandum in effect proposed still further direct government control of the entire economy.

The March 3 Treasury announcement is the first clear recognition that its efforts to hold yields on its long-term securities down to  $2\frac{1}{2}$  percent have been inflationary. But the new measure does not on its face seem adequate to solve the problem. The banking system could have been much better protected against a halt in the bond-pegging policy, for example, by allowing holders of outstanding long-term government bonds to convert them into bonds bearing a variable-coupon rate (see *Business Tides*, *Newsweek*, Oct. 4, 1948).

The inflation, in brief, has been government-created. And the alleged remedy of price-and-wage control (even if there had been no union-leader insurrection) is completely spurious. If the volume of money and bank credit were prevented from expanding, price control would be unnecessary. But as long as money and bank credit are being substantially increased in relation to the volume of goods, price control will continue to be worse than futile; for it distorts and disrupts production at the same time as it destroys economic freedom. ❁

## The CED on Price Controls

March 19, 1951

We take as our text this week a statement of the program committee of the Committee for Economic Development entitled “Conditions Necessary for Effective Price-Wage Controls.” This statement typifies the views of a large group of business leaders and economists. We choose it for discussion partly to point out what is wrong with it, but also to underline much that is right with it.

The committee specifies four conditions it regards as necessary to make “price and wage controls work as

effectively as possible: . . . (1) Drastic steps should be taken to reduce all government expenditures not clearly essential to the defense effort; (2) taxes should be raised sharply and promptly, to restrain consumers' expenditures as well as to increase revenues; (3) the expansion of bank credit should be checked; (4) a national program to encourage savings should be inaugurated."

By far the most important of these conditions is the third, which the committee relatively understresses. The increase of \$8,500,000,000 in combined demand deposits and currency outside of banks between the end of May and the end of December (together with fears of a still further increase) was *the* major factor in the inflation of that period.

But the committee argues clearly and courageously for "modification of the present policy of using the government's monetary powers to maintain a stable market for Federal government securities at low interest rates."

The first and second conditions specified by the CED committee add up to a demand for a balanced budget. Now a balanced budget is important. But a deficit is an *indirect*, not a direct cause of inflation. A budget deficit is inflationary only to the extent that it forces an increase in the volume of money and credit. A deficit fully financed by the sale of bonds paid for out of real savings, for example, would not be inflationary. But if the volume of money and credit increases, we can have inflation even with a budget *surplus*. This is precisely illustrated by what has been happening in the present fiscal year since July 1; for up to March 1 there was actually a budget surplus of \$978,000,000.

It is essential, moreover, to insist on drastic reduction of needless expenditures rather than increased taxes to bring about a budget balance. Continued taxes at any such level as \$70,000,000,000 a year (in dollars that retain even present purchasing power) would not only retard and discourage production but would make the maintenance of a free economy impossible. A budget of \$71,000,000,000 expenditures and \$72,000,000,000 taxes would be technically "noninflationary," while a budget of \$55,000,000,000 expenditures and \$54,000,000,000 taxes would be technically "inflationary"—but our economy would have a far better chance of survival under the second than under the first. Inflation is a great danger, but it is not the *sole* economic danger that threatens us.

The CED committee is right in maintaining that price and wage controls will not work effectively unless needless government expenditures are cut, the budget reasonably balanced, and further expansion of bank credit prevented. What it fails to recognize is that if

these "conditions necessary for effective price-wage controls" were achieved, the price-wage controls would not be necessary! For given such conditions, the general level of prices simply could not go up substantially or permanently.

It is true that the prices of certain war goods in exceptional demand might go up sharply. But this would leave less money to buy other goods, the price of which would consequently decline. And this change in *relative* prices is exactly what is necessary. To try to retain the same *relative* prices, wages, costs, profits (and losses) as those of June 24, 1950, say, is to discourage, retard, or prevent the very changes in the structure of production that we need.

Price control, in short, is not only an unnecessary weapon against inflation, but a positive evil in itself. ☸

## Point Four Is Growing Up

March 26, 1951

The global giveaway mania seems to grow by feeding on itself. The latest illustration is the report to the President by the International Development Advisory Board headed by Nelson Rockefeller. It proposes nothing less than a new \$4,500,000,000 foreign lending-and-giving program to the so-called underdeveloped areas of the world.

The Administration made Point Four look very modest and innocent at the beginning, you will remember, by asking for only \$45,000,000 for the first year. Now this sum was ridiculously small when compared with the grandiose objective of a new world flowing with milk and honey that Point Four was to bring about. It did not take much shrewdness to calculate that if there were 1,075,000,000 people in the "underdeveloped areas," then the \$35,000,000 actually appropriated meant only about 3 cents per ward per year—hardly enough to assure the economic millennium.

Some of us were so cynical as to ask whether the requested appropriation had not purposely been made ridiculously small compared with the tremendous pretensions of the program in order to lure Congress into accepting the *principle* that the American taxpayer somehow owed all the rest of the world a living. Even Democratic Chairman Connally of the Senate Foreign Relations Committee publicly expressed his apprehensions: "As time goes on I can feel the pressure coming in the window for big projects."



His prophetic soul did not have to wait long. Here, only one year later, is a program involving altogether 100 times as much as that modest little entry fee of \$45,000,000. And as I need hardly point out, we are not going to raise foreign living standards very much by lending or giving out only \$2 to \$5 per beneficiary per year. Will we be offered next year, perhaps, a really “adequate” program, bearing the same 100-to-1 ratio to this year’s, say, as this year’s does to last?

The stated purpose of this new proposal is to “unify” and “centralize” “all major United States foreign economic operations.” The board finds 23 American agencies already engaging in such operations in addition to 33 different foreign agencies. Its report admits, with masterly understatement, that “in some cases there is duplication.” But it does not specifically recommend the abolition of any one of these overlapping and duplicating agencies. It simply proposes to absorb them in a supercolossal U.S. Overseas Economic Administration.

Moreover, the report not only leaves some foreign hand-out agencies outside even this proposed consolidation; it suggests the creation of several new ones. One of them would be a new affiliate of the International Bank. With the ominous political record of the Reconstruction Finance Corp. before it, the board nonetheless proposes the creation of an “International Finance Corp. . . . to make loans . . . to private enterprise without the requirements of government guarantees.” And finally, though the new overall agency is of course put forward as “a vital part of our own defense mobilization,” it is nevertheless to be a “permanent governmental agency.”

As one who, in vain, wrote a 48 page pamphlet called *Illusions of Point Four*, it seems to me a rather futile exercise to call attention once more to all the false assumptions of theory and fact that underlie these Point Four proposals. Americans should be indebted, however, to Sir Ramaswami Mudaliar, the Indian representative to the United Nations Economic and Social Council (who demands that the U.S. provide bigger and better giveaway programs), for admitting so frankly that Point Four “may have to be at the expense of developed countries.” “The choice,” he says, “may be between a comfortable motorcar for an average American family or a motor truck for carrying passengers or goods in remote parts of the East.” At least Sir Ramaswami recognizes clearly that we in America must do with less if we give part of our goods away, whereas most of our own Point Four champions seem to argue that the more we give away the richer we will get. ☸

## International Statism Rampant

April 2, 1951

On March 19 the delegates of France, Western Germany, Italy, Belgium, the Netherlands, and Luxembourg initialed at Paris a draft treaty running for 50 years to give legal effect to the Schuman plan. It was another major step in the onward march of international bureaucratism, international controlism, and international statism.

The Schuman plan does have two merits. It represents a political rapprochement between France and Germany. And it recognizes, at least in the sphere of coal and steel, the evils of economic nationalism and fragmentation. But it resorts to a dangerously false method of meeting the problem. When we consider what it will mean from the standpoint of peace, freedom, and real internationalism in the long run, it is a grave step backward.

The truly liberal way for the six governments concerned to solve their coal and steel problem would be simply to lower or remove the legal barriers to international trade that they themselves have erected. This would mean the removal of tariffs, quotas, import and export prohibitions, license systems, and exchange controls.

Instead, the Schuman plan imposes new controls for old ones. It frowns, it is true, on *private* bigness, integration, or cartelization. But it will sanction and enforce all these things under intergovernmental direction. Under the plan the supranational control authority will have power to fix maximum, minimum, and “just” prices for coal and steel; to fix wages, production quotas, and consumption priorities; to subsidize submarginal companies; to guarantee private loans and to direct investment, financing expansion here and prohibiting it there. And to do all this the plan sets up elaborate bureaucratic machinery with consultative committees, and its own Assembly, Council, and Court of Justice.

In brief, in the name of freedom of competition the plan will prevent the very adjustments that it has been the immemorial function of competition to bring about—to allow and encourage the free expansion of efficient producers, to weed out the inefficient, to economize resources, lower prices, and promote maximum output.

Hardly was the ink dry on signatures to the Schuman plan than the French Government announced new plans to set up new supranational agencies with power to fix prices and allocate markets for Europe’s wheat, sugar, dairy products, wine, and whatnot. And the U.N. Economic and Social Council, meeting in



Chile, voted 13 to 0 that governments of the world combine “to regulate at equitable levels and relationships the prices of essential goods moving in international trade, including capital goods, essential consumer goods and raw materials”—in other words, to fix prices on practically everything.

All this is to be piled on top of what is already the greatest aggregation of overlapping intergovernmental agencies and collectivist controls that the world has ever known—from the International Fund to the European Payments Union, and from exchange controls to the wheat pact.

The fact that existing agencies and controls are either breaking down or promoting further economic chaos, instead of leading to any demand for their abolition, leads merely to demands for still more agencies, still more bureaucrats, still more controls. It is never the controls that are blamed for the resulting chaos, but the few remaining elements of freedom.

When the brief attempt to make pounds convertible into dollars broke down in 1947, the British Government blamed free convertibility, and not its absurd officially pegged price of \$4.03 for the pound. When Erhard finds it almost impossible in Germany today to maintain a few tiny islands of economic freedom in a sea of controls, it is the partial freedom, not the control, that is ridiculed.

The situation would not be quite so ironic if the bureaucrats of the world were frankly repudiating a free market economy. But world economic freedom is being strangled to the accompaniment of suave assurances that it is in the clutches of its friends. ❀

## Is Price Control Necessary?

April 9, 1951

The present price law expires on June 30, and the Administration is of course attempting to get even greater and more arbitrary control powers out of Congress. But if any economic sense prevails in Congress it will reduce and not increase the government's control powers. Above all it ought to reduce if not eliminate the Administration's power to fix prices.

I have argued so often on this page against price control that it will perhaps be more effective, and certainly more varied, if I cite the opinions and arguments of others. So I begin with a quotation from Frank H. Knight of Chicago, retiring president of the American Economic Association, from the *American Economic Review* for March:

“Of late, I have a new and depressing example of popular economic thinking, in the policy of arbitrary price fixing. Can there be any use in explaining if it is needful that fixing a price below the free-market level will create a shortage and one above it a surplus? But the public oh's and ah's and yips and yaps at the shortage of residential housing and surpluses of eggs and potatoes as if these things presented problems—any more than getting one's footgear soiled by deliberately walking in the mud.”

I turn next to an article, in the same issue of the same learned quarterly, called “Is Price Control Really Necessary?” It is by Profs. Wytze Gorter and G.H. Hildebrand of the University of California at Los Angeles. “The duty of professional economists,” they declare, “is clear: to demonstrate once again the superiority of the price system over direct controls, even in the management of a preparedness economy.” And they proceed to advocate a pay-as-we-go system (which they call a “cash and carry fiscal-monetary policy”) with free prices and free markets, as “an alternative to the interminable queues, stamps, boards, and bureaucrats” of price control.

Exhibit C is a little 24-page pamphlet on *Inflation*, by F.A. Harper, just published by the Foundation for Economic Education. (Irvington-on-Hudson, N.Y. No charge for single copy.) I commend this for the simplicity and clarity with which it states the case against price control. Professor Harper begins by pointing out: “Inflation means too much money. The way to prevent inflation, is to close down the money factory. It is just that simple.” If it closes down the money factory, the government must live within its income. Inflation is a form of tax. When the government starts to appoint “inflation fighters” it is in effect illogically setting up a branch for the purpose of fighting the payment of the inflation-tax that it has assessed through another branch.

Price-ceiling laws, as Harper goes on to point out, were imposed at least as far back as 3,800 years ago in ancient Babylonia. They have always created shortages. Our memories are so short, however, that we have even forgotten the “meat famine” that price ceilings created in this country in 1946. Harper proceeds to give an elementary lesson on the way in which the free market price equalizes supply and demand and maximizes production and consumption, whereas arbitrarily fixed prices cause disequilibriums—distortions, surpluses, and shortages. “When the free market is allowed to operate and to set the price at a point where supply and demand will equate, each person will have purchase

tickets in the market which correspond to the supply of something he puts into the market.”

In spite of the conclusiveness of the case against price control, the general ideological and political confusion is such that there is little practical hope that Congress will allow price control to terminate. But we can hope that it will at least put a light trigger on any renewal of its economic control legislation, that it will extend any control law for no more than a year, and retain the power to terminate even that at any time upon the vote of a simple majority of *either* House. Congress should not continue to be helpless against bureaucrats who issue nonsensical orders in the name of carrying out the will of Congress itself. ❁

## Controls Create Inflation

April 16, 1951

Congress can do most to curb inflation by granting the Administration and its agencies fewer control powers, not more.

Price control is not a remedy for inflation. It actually tends to increase and prolong inflation. It distorts and prevents production, and so brings about needless shortages. It diverts the attention of the general public from the real cause of inflation—the increase in money and credit.

It does not follow that the best way to combat inflation is to grant the Federal Reserve authorities more power over money and credit. On the contrary, a more effective step would be to deprive the Federal Reserve authorities of some of the powers they have been abusing for so many years.

Suppose, for example, that Congress deprived the Federal Reserve Banks of the power to buy more government securities. The Treasury would then be obliged to pay high enough interest rates to make its securities attractive to investors on their own merits. It could no longer force the Reserve Banks to peg the price of its bonds. In effect, the government would have to stop selling its bonds to itself. The Reserve system could no longer hold down interest rates artificially by monetizing government bonds.

If government agencies were no longer permitted to increase the supply of money and credit through this device, interest rates would rise. And permitting interest rates to rise—i.e., making credit more expensive—has been the traditional way of bringing inflation to a halt.

Simply permitting interest rates to rise might be enough to halt the present inflation. There are still the possibilities, however, (1) that member banks might increase their holdings of government securities and (2) that, in spite of higher interest rates, private credit might continue to expand. There are several ways in which such developments could be checked.

Further limitations might be put on the power of the member banks to increase their holdings of government securities. The Federal Reserve authorities might be empowered to raise member bank reserve requirements still further. But they should certainly not get this additional power unless it is accompanied by the obligation to increase the reserve requirements of the Federal Reserve Banks themselves. Their reserve requirement against combined liabilities, now only 25 percent, should be restored to the 35 to 40 percent level that existed before 1945. Such an action on the part of Congress would not only restrict further potential credit inflation but would create an immediate increase of confidence in the dollar. Congress should restore the old legal requirements before still further inflation has occurred. The combined reserve ratio of the Federal Reserve Banks is already down to 46.6 percent compared with 56.5 percent a year ago.

Raising legal reserve requirements is a relatively clumsy way of controlling credit. This supplementary device is necessary chiefly because the Federal Reserve authorities have not shown the courage to make full use of the powers they have always had—to increase the discount rate to a noninflationary level and, if necessary, to sell part of their holdings of government securities back to the market. Combined action of this sort could halt inflation overnight.

Just as Congress could do more to curb inflation by placing restrictions on the Federal Reserve authorities than by granting them further control powers, so it could do more by taking some powers from the Federal bureaucracy in general than by adding new ones. Above all, in a time of inflation Congress should discontinue subsidies to farmers, and the “parity” price nonsense, and reconsider all other legislation which arbitrarily forces up production costs.

The Federal Reserve authorities are always asking for more powers for the ostensible purpose of “combating inflation.” But they have in fact used the powers they have in order to create inflation. The way to halt inflation is not through controls *by* government but through controls *on* government. ❁

## Priorities vs. Price Control

April 23, 1951

On April 6, 7, and 8 I attended a conference on “the economics of mobilization” at White Sulphur Springs under the sponsorship of the University of Chicago Law School. There were some 70-odd participants, consisting of university professors of economics and law, representatives of labor, banking, and business, editors, members of Congress, government officials, former price control directors and the present Director of Price Stabilization, Michael V. DiSalle.

In view of the diversity of views expressed, DiSalle could hardly be blamed for remarking that “the experts are much more effective talking to nonexperts than they are talking to each other.” But the chief reason why this was so was that many of the professional economists present abandoned their function as economists in order to become amateur politicians. They did not talk of the economic consequences of price control but of its political popularity. They made no real answer to the argument of those who held that the only way to prevent further inflation is through proper monetary and fiscal policy, and that price-wage control not only fails strike at the root causes of inflation but impairs the general efficiency of the economy and even of the armament effort.

This contention, shared by most of those who came to the conference from the University of Chicago itself, will not be unfamiliar to the readers of this column. As pointed out at the conference, the country’s bank loans rose from May 31 to the end of 1950 by nearly 20 percent, while demand deposits increased more than 9 percent. It is this increase in money and bank credit that financed the rise of 11 percent in wholesale prices and of 6 percent in living costs.

What was most remarkable about the conference was not the political defense of existing price and wage controls but the number of those who condemned the whole policy not merely in details but in principle.

There was instructive discussion of some technical questions. Herbert Stein, for example, of the Committee for Economic Development, pointed out that even where such direct controls as priorities and allocations might be necessary, price controls would still be both unnecessary and undesirable.

As examples, Stein cited such industries as machine tools and steel. These are already working at capacity; they cannot make some deliveries for many months; and they customarily fill first the orders longest on the books. In place of such a “private rationing system,” Stein advocated government priorities and allocations to permit the quickest military deliveries.

Few persons, I believe, would venture to deny the need for this particular kind of priority in wartime or in a defense emergency. But there are several implications of this kind of control which are usually overlooked by those who are most insistent on it. It is not needed where prices have risen too much, but, as Stein points out, where prices haven’t risen “fast enough and far enough to . . . eliminate an excess of demand.” Price ceilings, so far from reducing the need for such priorities, simply make their need “more widespread and more persistent.” Such priorities are “a means of supplementing the allocating function of price where prices do not rise enough to do the whole job.”

This is the opposite of the doctrine usually voiced. It is recognized by most economists (though not yet, apparently, by our present price fixers) that price ceilings do not make sense without priorities, allocations, and rationing. But the converse is not true. Though price ceilings make allocations necessary, allocations do not make price ceilings necessary. On the contrary, they tend by themselves to hold down prices, by reducing demand. They work much easier without price ceilings than with them. For administrators are not then confronted with the impossible task of trying to solve all three determinants in the supply-demand-price equation simultaneously. In brief, though price ceilings cannot work long without rationing, rationing works better without price ceilings. Rationing helps price ceilings, but price ceilings thwart rationing. ❁

## Gold Standard vs. Inflation

April 30, 1951

Congressman Howard Buffett of Nebraska, one of the ablest members of the House Banking and Currency Committee, sent out a questionnaire on inflation and the gold standard to the nation’s bank presidents and bank chairmen. He sent out 16,748 letters in all, and got back 666 replies. These replies came from banks representing more than 20 percent of the nation’s bank deposits and showed a remarkable consensus.

There were four questions in all. No. 1 was: “Do you believe that price and wage fixing will effectively prevent inflation?” Only 7 percent of those answering the question said Yes; 93 percent said No.

Question No. 2 was: “Have you been able to find satisfactory evidence that Congress can resist spending pressures without the historical restraint of a currency redeemable in gold on demand?” Only 7 percent said Yes; 93 percent said No.



Question No. 3 was: "Do you believe expansion of the money supply can be effectively restrained when long-term government bonds are rigged at the 2½ percent level?" Only 9 percent said Yes; 91 percent said No.

Question No. 4 was: "Would you support the Reed bill, HR 324, to promptly reestablish redemption in gold of our currency at \$35 an ounce? I was the introducer of this bill in the 80th Congress. (Copy attached.)" Seventy-three percent of those replying said Yes; 9 percent said in effect Yes but not now; 7 percent were undecided, and 10 percent said No.

Individual replies to the Buffett questionnaire were interesting for their comment. But the most interesting and encouraging, to my mind, came from outside the banking field—from Allan B. Kline, president of the American Farm Bureau Federation. He wrote in part:

"Nothing but disaster can result if we allow the delusion that price and wage ceilings can stop inflation to prevent the adoption of policies which actually will control inflation by bringing about (1) strict economy in government expenditures, (2) a pay-as-we-go tax program, (3) effective credit controls, and (4) a sound management of the public debt. . . .

"Fixing prices and wages would unquestionably reduce production. . . .

"In the present situation . . . we must cut non-defense program expenditures throughout the Federal budget. As an indication of our willingness to do this in agriculture, we are recommending that the authorization for a 1952 agricultural conservation program be reduced from the budget recommendation of \$285 million to \$150 million. . . .

"We aggressively oppose the extension of price and wage controls beyond the present expiration date of June 30, 1951, since these controls are diverting attention from the things which must be done if we are to have an effective program for the control of inflation."

My own answers to the Buffett questionnaire would include a clear-cut No to questions No. 1 and No. 3. To question No. 2 I would reply that a currency redeemable in gold on demand is a necessary restraint on Congressional spending pressures but not in itself a sufficient one. To question No. 4, I would agree in principle with the purpose of the Reed bill, which is to return to a gold standard, but I would have reservations about the "promptly" and about the rate of \$35 an ounce. The gold standard cannot be considered in isolation. We can restore and maintain it only as an integral part of an entire system of economic freedom, unhampered markets, solvency, prudence, and good faith. Finally, the conversion level at which we return to a full gold standard must take account of the tremendous American

and foreign inflation and the rise in world prices since 1934.

But what is centrally important is to recognize that a return to reasonable monetary stability, an end to inflation, a resumption of freedom of world trade, an escape from bureaucratic arbitrariness and caprice, will be possible in the long run only with a return to a full gold standard. And it is heartening to find that there are still men in Congress with the vision to see this and the courage to fight for it. ☼

## We Have Asked for Inflation

May 7, 1951

The main reason we have inflation in this country today is that, by and large, we have asked for inflation.

It is amusing to hear politicians talk of inflation as if it were a visitation from without, in spite of our will, like a flood, a hurricane, an army of locusts, or the bubonic plague. The truth is that we could stop inflation, if we wanted to, overnight.

Not by price control, of course, which is an irrelevant and completely fraudulent remedy for inflation, favored by some groups precisely because it can never really be successful. The government can halt inflation by the simple process of ceasing to create inflation. All it has to do is to keep the budget balanced (as it is in the current fiscal year) and stop monetizing its existing debt by buying its own bonds through the Federal Reserve Banks. If it did this, interest rates would go up for the simple reason that they were no longer artificially held down. And higher interest rates would discourage the expansion of private credit.

These steps alone might prove to be enough. If they weren't, then the Federal Reserve authorities could take the initiative in selling government securities, raising discount rates and raising legal reserve ratios. That's all. The Federal Reserve authorities already have practically all the powers they need; what has been lacking is the will to use them.

Inflation is caused by an increase in the volume of money and bank credit in relation to the volume of goods. Halt this increase, and the fear of any future increase, and you halt inflation.

We hear predictions that if the Federal Reserve authorities used their existing powers to halt inflation all sorts of terrible things would happen. It is true that outstanding government securities, lacking an automatic buyer at an artificial price, would fall. But this problem could easily be taken care of by allowing long-term bonds to be converted into new bonds at a higher



rate of interest. We also hear predictions that commodity prices would stop rising, and might even fall. But the people who complain of this are admitting that they prefer the certainty of more inflation to the risk of even a little deflation.

And this brings us to the heart of the problem. Ever since 1932 the world has been haunted by the specter of deflation. Rather than face up to even a touch of it, people have asked for greater and greater doses of inflation. Since the end of the second world war, whenever there has been even a slight sinking spell in prices, there has been a resumption or speeding up of inflation as the cure.

The farmers have demanded subsidies, support buying, "parity" prices. Industrialists have granted huge wage increases and then demanded inflation in order to pay them. Labor-union officials seem secretly to welcome continuous price advances because then they can demand, and get, a continuous series of wage increases—thus proving to the rank and file how necessary the union officials' services are. Most of us still retain the delusion that under inflation we can gain more in our role as sellers and producers than we must lose in our role as buyers and consumers.

The pressure on the politicians to continue a policy of inflation is enormous. For the fetish of today is "full employment." This can be achieved, for a time, by continuously adding to the supply of money and credit while holding down the consequent rise in prices and wages just enough to assure that demand is kept always a little in excess of supply. The scheme works only by a tremendous growth in state power and by progressively depriving the people of more and more economic liberty by imposing price and wage control, allocations, rationing, labor direction. In the end it breaks down anyway, by demoralization of the currency.

But it will clarify thought in the meanwhile if we recognize that we are getting into this policy of "repressed inflation" because this is the policy we have been asking for. When we seriously want a halt to inflation we can get it within 24 hours. True, any attempt to halt inflation brings the risk of *some* deflation. But to refuse that risk is to ask for more inflation. ☸

## Why Price Control Should Expire

May 14, 1951

The President's message to Congress asking for extension and "strengthening" of the Defense Production Act is a very curious document, replete with passages that cannot be reconciled with each other.

At one point he even declared plainly: "Price and wage controls do not cure the basic cause of inflation—the inflationary gap between the supply of goods and the volume of buying power. The cure can come about only by closing the gap." In other words, price and wage controls are not only irrelevant, but distract attention from the real cure for inflation.

Yet Mr. Truman nevertheless went on to insist on "stronger" price and wage controls. He even announced that government policy planned to permit or encourage the very "inflationary gap" that causes inflation. In the next two or three years, he said, there will be "more money available for people to spend" at the same time as there will be "much less civilian goods for people to buy." This can only mean that while Mr. Truman talks bravely about taxing away surplus income, "paying for government expenditures as we go," and tight credit restrictions, he does not seriously expect to adopt these programs.

There are other inconsistencies no less serious. In one breath he urges "holding the line on food prices." In the next he praises the "parity principle," which forces up food prices, as "the basis for our agricultural laws" and "the best guide we now have available to judge what is a fair return to farmers." And then he seeks to conceal this contradiction by advocating food subsidies—apparently on the theory that if the American people are forced to pay part of the higher food prices as additions to their tax bill instead of to their grocer and butcher bills they will never notice it. The fiasco of England's food subsidy program seems to hold no lessons for Mr. Truman except a yearning to imitate it.

Again, Mr. Truman continues to apply a double standard to price control and wage control. He asks for "ceilings" on prices and rents; but wages and salaries he merely wants to "stabilize."

He urges everybody to invest again in U.S. savings bonds. "After the war," he says, "those savings helped many a family." He neglects to add that as a result of his own and his predecessor's "inflationary gap" policies, which he proposes in the main to continue, those bonds have a much lower purchasing power than when they were bought. He is trying to get savings through exhortation while ignoring incentives.

If Congress is well advised, it will not give Mr. Truman the kind of Defense Production Act for which he now asks. It will allow the present wage-and-price-fixing powers to lapse entirely, on the following grounds: (1) As even the President now concedes, they do not cure the basic cause of inflation. (2) They divert public attention away from the real cure. (3) The price regulations put into effect in January, as the President

himself admits, “inevitably . . . froze all sorts of distortions and inequities into the price and wage structure.” (4) Our present price fixers have apparently learned nothing from the mistakes of OPA; their new meat-price-control orders threaten to bring on a meat famine paralleling that in the fall of 1946. (5) Even the best-intended price control unbalances and reduces production. (6) No political-minded administration can be trusted to refrain from using price-and wage-fixing powers to propitiate powerful voting groups and to make scapegoats out of weak ones.

(Example: If the “parity principle” is “the best guide” to what is “fair,” why apply it only to farmers? Why not to everybody? Yet no one has proposed to apply the parity principle to rents, say, as well as food prices.)

Mr. Truman wants the life of the new Defense Production Act extended for two years. But Congress could assure more careful executive compliance with the act by extending it only for one year, and by providing, in addition, that it could be terminated at any time even before then by a majority vote in either house. ❁

## End Price Ceilings—and ‘Parity’

May 21, 1951

At this moment Congress has a rare opportunity. The economic situation and political sentiment at last combine to make it possible to return to free markets—to get rid of both price ceilings and “parity” price supports at a single stroke.

The price-control program is heading into obvious absurdities and inconsistencies. The government is asking for subsidies and “parity” to put farm income and food prices up, and price ceilings to hold them down. It wants to put its foot on the gas and the brake at the same time. The result of that kind of driving, as it ought to have learned, is not to maintain an even rate of speed, but to stall the motor.

The public is becoming disillusioned with price control. So are special groups. Neither workers nor employers can understand wage ceilings that are riddled with exceptions, or escalator clauses for some and not for others. Meat producers and congressmen from cattle-raising states are appalled by the ineptitude of the beef-price “rollback” and predict that it will bring the same sort of beef shortage as in the fall of 1946.

The influential American Farm Bureau Federation is now opposing the continuance of price control in general, and not merely for farm products. This is something different from the tactics of those groups which have put themselves in the untenable position

of demanding tight price control for what they have to buy, while vehemently opposing it or demanding loose standards, for what they have to sell.

Of course the OPS warns that without price control living costs may skyrocket. But Congress can prevent this by insisting on a balanced budget and an end to the credit expansion policies of the Treasury and the Federal Reserve System. This is the real remedy for inflation; price control is a fraudulent one.

Labor officials are right in fearing wage control. Farm groups are right in opposing price control. Price ceilings on farm products—whenever those ceilings are below free-market rates—chronically bring black markets or food shortages. In Yugoslavia and India today price ceilings have even brought famines, which are then blamed on “droughts” or “floods” or anything but government policy.

As a condition for granting relief from wage control and price control, Congress and the consumers have a right to demand a quid pro quo. They should remove not only the ceilings but the floors. Congress should not only allow wage control to lapse, but should repeal the Walsh-Healey Act. In addition, it might fix the minimum legal hourly overtime rate at \$1.12½ (50 percent above the minimum straight-time rate of 75 cents) and leave higher overtime rates to be determined by collective bargaining.

As applied to agriculture, Congress should end the whole “parity” price formula. That formula constantly raises the food prices paid by city workers. It is a built-in “inflationary pressure.” It tries to freeze forever the price relationships that happened to prevail in a carefully selected five-year period nearly 40 years ago. If that formula is really sound it ought to be applied universally—to steel, aluminum, freight rates, rents, neckties, haircuts—in fact, to the price relationship of every commodity in 1910–14 to every other.

I cannot recall that any member of the farm bloc ever suggested this. In February of this year farm prices averaged 13 percent above even the parity level. This is another way of saying that industrial and other prices averaged 11 percent *below* the parity level. The farm bloc did not recommend correcting this inequity. “Parity” is a one-way street.

Of course the whole principle of freezing past price relationships is wrong, whether they happen to be the prices of 1910–14 or of June 24, 1950. We freeze the price structure merely at the cost of distorting the structure of production. The very function of free prices and free wages is to balance and synchronize production as among thousands of different commodities and services. Optimum employment and production need two-way

freedom for wages and prices. Controls are no substitute for the graded incentives of the market. ❁

## More Powers—or More Curbs?

May 28, 1951

The Administration has asked not merely for a two-year extension of the present Defense Production Act, but for a large increase of control powers. And no doubt many congressmen fear that if they do not grant these additional powers, they will be blamed for any further inflation on the ground that they failed to provide the “weapons” to “combat” it.

Yet if it wishes to frame a really effective law against inflation, Congress cannot permit itself to be intimidated. It should allow the present powers of price and wage control to expire entirely. Price and wage control is a fraudulent weapon against inflation. It merely distorts and reduces production.

Nor should Congress grant most of the additional powers for which the Administration now asks. If there were no price ceilings on food, then obviously there would be no excuse for the food subsidies that the Administration wants. Those subsidies would in any case serve no purpose except to conceal the real rise of food prices in an increased tax bill. Again, if other prices are not held down by government edict, there is less excuse for the differential subsidies, the “power to give special financial aid to high-cost producers,” for which the President has asked. Differential subsidies easily lend themselves to favoritism and abuse. With the example of the RFC before it, Congress should be slow to create more opportunities for influence and free mink coats.

Congress should also hesitate to grant a sweeping renewal of rent control. If it insists on imposing more rent control, it should be in the form of permitting no more than a 10 or 15 percent increase each year until rents have caught up with the average rise in other prices and costs since 1935–39.

Jess Larson, who was head of the War Assets Administration after the second world war, has told Congress to act “very hesitatingly” in granting the government the sweeping powers it asks for to build its own new defense plants. Disposing of government plants after the second world war, he points out, cost nearly \$1,000,000,000 “just for overhead,” not counting the loss to the taxpayer on the sales themselves. It would not be too much to require the Administration to get specific Congressional approval for each plant it wanted to build.

All this does not mean that the whole Defense Production Act should simply be allowed to expire. Extension of some powers is needed. Even more, some explicit curbs are needed on existing government powers.

Congress should not merely remove ceilings on prices and wages; it should at the same time remove present legal floors on agricultural prices and discriminatory floors on wages (as represented, say, by the Walsh-Healey Act and the penalty overtime provisions in their present form). Congress should continue to authorize material allocations and priorities. These are more effective, in fact, when *not* accompanied by price and wage ceilings (see *Business Tides*, April 23).

Most important of all, Congress in the new law must strike at the real cause of inflation. It should: (1) Declare that the root cause of inflation has been the increase in the supply of money and credit, and that the government-bond-support policy of recent years has been inflationary because it has produced this increase in money and credit. (2) Declare that the Federal Reserve Board is not subordinate to the Treasury, and should not be forced to support government obligations issued by the Treasury at inadequate interest rates. (3) Restore the required legal reserve ratio of the Federal Reserve Banks against deposits and notes to at least 35 percent, and authorize the board to increase this reserve ratio even further. And if it permits the board to increase further the reserve ratios of member banks it should do so only on condition that the board orders at the same time a corresponding increase in the required reserve ratios of the Federal Reserve Banks themselves.

Congress can act to combat inflation only by forcing the Treasury and the Federal Reserve System to live up to the responsibilities they have shirked for the last ten years. ❁

## The Future of ‘Fair Trade’

June 4, 1951

The Supreme Court has ruled that retailers are free to ignore “fair trade” agreements, designed to prevent price cutting, if they do not sign them. It is too early to say exactly what the practical result of this decision will be. Some lawyers contend that it in effect nullifies all the “fair trade” laws in 45 states. Others argue that it nullifies only the “non-signer” clause of state fair-trade laws, and even this only as it applies to interstate, not intrastate, commerce. But while manufacturers are



apparently still free to refuse to sell their products to a retailer who will not sign a fair-trade contract, many of them doubt the practicability of attempting to get a contract from every dealer.

The non-signer clause, in existing state fair-trade laws, provides that when a manufacturer has obtained the signature of even one retailer to a minimum-price agreement, all other retailers in the state are bound by it. According to the new Supreme Court decision, the Federal Tydings-Miller Act, which was previously thought to uphold the state fair-trade laws in full, simply permits an individual retailer and a distributor to fix a minimum retail price that would otherwise be illegal. "When they seek, however," continues the six-man majority of the court, "to impose price fixing on persons who have not contracted or agreed to the scheme, the situation is vastly different. That is not price fixing by contract or agreement; that is price fixing by compulsion. . . . Contracts or agreements [the phrase used in the law] convey the idea of a cooperative arrangement, not a program whereby recalcitrants are dragged in by the heels and compelled to submit to price fixing."

Whether or not this is a correct interpretation of the words of the Tydings-Miller Act or of Congressional intent, it is sound legal and economic principle. The chief valid argument in favor of price-maintenance laws is that government should permit freedom of contract and uphold voluntary agreements. But this argument cannot be applied in cases where no real contract or voluntary agreement exists.

Most of the other arguments in favor of price-maintenance laws are dubious. No doubt they make some things easier for the salesman for the manufacturer. The small retailer's markup on the product is practically guaranteed; his larger or more efficient retail competitors, he is assured, cannot cut prices on him. But this also works the other way. The larger retailer may place a smaller order than otherwise because he cannot offer his customers any special price advantage. And the retailer who is overstocked or needs cash can't cut his price to whatever level he thinks will move the goods.

The manufacturer's real protection for his brand name lies in maintaining the quality of his product rather than in maintaining a uniform retail price for it. He is more likely to gain and keep consumer good will by trying to prevent retailers from selling his product at *more* than a "fair" markup than at less than one. And if the average price of his product is lowered by individual price cutters, he is likely to sell more of it rather than less.

It is often argued that price-maintenance laws, by protecting the small retailer, promote rather than prevent competition. This would no doubt apply to carefully drawn laws designed to curb clearly unfair practices—for example, against selling below actual cost with the deliberate intent of putting small competitors out of business in order to raise prices again later on. But that such practices are really frequent may be seriously doubted. In any case, preserving competition should not be identified merely with preserving inefficient competitors. Retailers exist for consumers, not consumers for retailers.

When we look at the problem from the standpoint of the interest of the consumer, we recognize that there is no merit in any law which tries to hold up prices arbitrarily merely to "help the small retailer." Higher prices reduce consumption. Less consumption means less production, less employment, and lower living standards. ❁

## Foreign Giveaway Grows

June 11, 1951

The Administration's foreign giveaway program has grown by feeding on itself. The State Department wants to meet new foreign problems chiefly by handing out money because it has met past foreign problems chiefly by handing out money. It keeps changing the reasons for handouts but never the practice.

It now wants to spend \$8,500,000,000 in the next fiscal year for foreign aid. Of this sum, \$6,250,000,000 would be for "military" and \$2,250,000,000 for "economic" assistance. Just why we must give away additional billions for "economic" aid is not clear. Even Mr. Truman admits: "The original goals of the Marshall Plan have been largely achieved." Why, then, start setting up new goals? Italy's index of industrial production is running about 30 percent above the prewar figure; the United Kingdom's, 50 percent above; France's, 40 percent above. Even if we grant the debatable proposition that it was the American taxpayer's duty to restore Europe's production to the prewar level, on what theory is it his duty to continue pouring in gift money now that European industrial production is well above the prewar level?

Similar questions may be raised about "military" aid. The North Atlantic Treaty, however desirable or even essential, was in itself an unprecedented and tremendous commitment. It is far from clear why we must take on the additional task of paying for part of the armament of practically all our Allies. This is an



economic, not a military decision. It is for the military experts to say that a given Western European country needs so many tanks or planes. But it does not follow that we should turn all of them over as *gifts*. If a country buys them, it sends us other goods, military or civilian, in exchange—and so gives reality to the “mutual” part of “mutual aid.”

To *give* arms to Europe is to assume that Europe cannot afford to pay for these arms out of its own resources. This, to repeat, is a purely economic, not a military assumption; and there is no evidence to show that it is justified. Western Europe in 1951 is planning to spend only about 8 percent of its gross national product for armament compared with an American expenditure of about 15 percent. There is nothing to show that the sums we are giving to Europe for armament are not purely arbitrary in amount—or even that they are necessary at all.

The division, moreover, between “military” aid and “economic” aid is also in practice purely artificial. To give European governments \$1,650,000,000 in “economic” aid is to relieve them of that burden. They can then spend that much more money on increased armaments without adding to the total they would otherwise have had to lay out. If, on the other hand, we give them \$5,240,000,000 for “military” aid, then, unless their total rearmament budget is at least \$5,240,000,000 *more than it would otherwise have been*, we have simply released all or part of their own funds for other kinds of expenditures. The only way we can be sure of protecting our gift funds against such a diversion is to dictate every item in the European budgets—which no one would seriously recommend.

What our foreign aid does, in effect (whether it is labeled “military” or “economic”) is to put heavier burdens on American taxpayers in order to relieve European taxpayers. And as every American is not richer than every European, “foreign aid” puts heavier burdens on many poorer U.S. taxpayers so that lighter burdens may be put on richer European taxpayers.

The politics of our foreign-aid program are as mystifying as the economics. Mr. Truman begins by telling us that the purpose of our handouts is to help the “free nations.” Now we find that these include the Communist dictatorship in Yugoslavia and the Fascist dictatorship in the Argentine. Most fantastic of all, Mr. Truman proposes to reward the Persians for seizing vital oil from the Atlantic Treaty nations by giving Iran still more money. If the present situation in Iran is not enough to puncture the iridescent bubble of the Point Four dream, is anything at all capable of waking the White House to realities? ❁

## Price Controllers in a Panic

June 18, 1951

As the June 30 deadline approaches, when the present price-and-wage control law is due to expire, the statements of the price controllers take on a note of desperation. Mr. Truman professes to fear “an unmanageable torrent of inflation”—which could, in fact, only be caused by his own fiscal and monetary policies. Eric Johnston, Economic Stabilization Administrator, declares that those who oppose the continuance of price and wage controls are led by special interests whose whole attitude is “damn the consumer, and full pockets ahead.” They are “grinding their own ax without thought for the welfare of anyone or anything else . . . at a time when men are dying in battle in Korea for a free way of life.”

It is sad to find Eric Johnston impugning the intelligence, motives, and patriotism of those who disagree with him. Nor does it seem wise for the advocates of price control, in their own interest, to put the argument on an *ad hominem* basis. Their own sincerity and disinterestedness are not altogether above question.

How seriously, for example, can we take Bill Green, president of the AFL, when he pleads for wage controls instead of free collective bargaining? “If price controls were scuttled,” he says, “wage stabilization would have to go and there would be no limit to the amount of wage increases unions could obtain from employers.” It is surely suspicious to find Bill Green worrying about how high wages might soar unless the government held them down with a firm hand. Some of us suspect that “wage inflation” would not be a very serious problem if the government itself refrained from inflating money and credit and stopped creating boards and “stabilization” formulas that force wage increases on employers.

It is not for nothing that the Wage Stabilization Board is beginning to be called the Wage Stimulation Board. It began by issuing a so-called “catchup” formula under which wages were “allowed” to go 10 percent over the Jan. 15, 1950, level. But what a government board once “allows”, it is taken to approve, sanction, and practically to direct. Then on April 25 Economic Stabilization Director Johnston approved a 6-cent-an-hour cost-of-living increase for nonoperating railway workers. This was 3½ cents above the 10 percent limit. On May 18 the WSB itself allowed a 9-cent-an-hour increase for packinghouse workers, which punched such a gaping hole in the ceiling that even the Board said: “We are fully aware that this decision looks in the direction of a new policy.”

Meanwhile the Board approved cost-of-living escalator contracts signed before Jan. 26, 1951. It has now unanimously approved automatic so-called “productivity increase” pay boosts in contracts signed before the same date. What sort of ceiling is it that is full of holes at the beginning and moves upward with every new major decision? And how long does the Board seriously think that it can use an arbitrary date to approve increases for some workers and withhold them from others? Already Eric Johnston wants to give wage increases to everybody to compensate for the rise in living costs since Jan. 15, 1950. Many labor leaders are willing to “accept” this fake wage control for their own groups in the hope of imposing real price control on others.

As for farm groups, they hardly know where they stand at the moment. A government that has already lost \$276,000,000 (through the Commodity Credit Corp.) so far in this fiscal year, in its efforts to hold some farm prices up, is trying to roll meat prices down. It seems on the verge of duplicating the consequences of meat price control in 1946. On June 6, as a typical example, one of the “Big Four” packers slaughtered only one-tenth of its normal quantity of cattle at its Chicago plant because the cattle raisers and feeders would not offer any more at the government ceiling prices.

Even if price and wage control were put in the hands of economic geniuses and political saints it could not be made to work. It creates and intensifies shortages. But when it is cynically used as a political football, it becomes altogether intolerable. ❀

## An Anti-Inflation Program

June 25, 1951

Regardless of what Congress actually does before June 30, it is instructive to consider what a sensible anti-inflationary legislative program would be like if we could get it.

1—What is primarily needed is not more controls *by* the government but more controls *on* the government. It is government policy, and government policy alone, that creates hyperinflation. Inflation means an increase in the volume of money compared with the volume of goods. It is government policy that either permits, encourages, or directly produces such an increase.

2—The enormous increase in the volume of money and credit since 1939 has been directly caused by the policy of cheap money and government bond support followed by the Federal Reserve System. That policy should be definitively stopped by Congressional direction. And whether or not powers are given to the

Federal Reserve to increase still further the required reserves of member banks, Congress should restore, at least to their pre-1945 level, the required reserves of the Federal Reserve Banks themselves. It is absurd to control the low-powered credit of installment buying and the medium-powered credit of member bank loans, while failing to put even normal restraints on the high-powered credit created by the Federal Reserve Banks.

3—Congress should insist that the Administration keep the Federal budget balanced. Budget deficits cause inflation by forcing an increase in the volume of money and credit. The budget should be kept balanced mainly, of course, by drastic slashes in unjustified expenditures rather than by still more burdensome taxation.

4—Price control should be dropped. It is a fake remedy for inflation. It creates and intensifies shortages. It prolongs inflation by diverting public attention from the real cure, which is simply for the government to stop printing more money. It leads to ever-widening government controls, which tend to stay long after the “emergency” which was the original excuse for them has passed. The controlled economies of Europe, and the permanence of rent control almost everywhere, are typical examples. The price controllers neither understand nor trust the workings of a free market.

5—The Administration’s priority and allocation powers, though they have so far been handled rather ineptly, should be continued. The controllers usually try to tie in price control with allocation powers. But while price control creates a need for rationing and allocation, the causation does not work the other way. Allocations work best *without* price control.

6—No good case has been made out for any of the additional powers asked for by the Administration. The proposed food subsidies, for example, would be merely a way of concealing real inflationary increases in costs by adding them to your tax bill instead of to your butcher or grocer bill. The only way the British Labour Government could keep the cost of meat subsidies from going up was to forbid British consumers to eat more than two mouthfuls meat per week. Where there is no price control, there is no excuse for a food subsidy.

7—There is no convincing case, either, for giving the government the blanket discretionary powers it has asked for to build its own “defense” plants. It has not proved that it cannot get private industry to build and operate such plants, and at a far lower cost than the government could. If there should turn out to be a real need for a few plants that private industry would not in fact build, the Administration could go to Congress for specific authorization to build each of those plants. If any project were alleged to be top secret, it could appear

in a Congressional bill as project X4Y, but at least a few key members of the Military Affairs Committees should know what it is.

8—In the light of sad experience, any extension of controls should carry a double termination trigger. In no case should extension run for more than a year. In addition, the new law should be terminable at any time by a majority vote of either House of Congress. Congress should never make itself impotent to repeal emergency powers that are being abused or that have ceased to be needed. ☸

## ‘They Told Us Then . . . ’

July 2, 1951

Mr. Truman’s radio appeal of June 14 exposed more than ever the logical and factual weaknesses of the Administration’s case for price control.

“These people who say we should throw out price controls and rent controls,” the President said, “are all wrong. They are just as wrong now as they were back in 1946. They told us then that if we would just put an end to price controls, everything would be rosy and prices would stay right in line.”

Though prominent labor leaders and farm groups have been opposing the continuance of price-and-wage controls, Mr. Truman picked the National Association of Manufacturers to symbolize the whole opposition. “The NAM,” he said, “put full-page advertisements in the papers all over the country [in 1946] saying if we would just take off price controls, there would be plenty of things to buy at reasonable prices.”

The NAM did make the mistake of implying that if price controls were removed, the competition and increased production resulting would in themselves bring down prices. But what Mr. Truman has forgotten is that this mistake was not confined to the NAM. It was President Truman himself who, on Feb. 14, 1946, declared: “Production is our salvation. . . . Production will do away with the necessity for government controls.” And Chester Bowles, his price administrator, said four days later: “Production is the only answer to inflation.”

I recall these statements because I quoted and took issue with them in an article in *The New York Times* of Feb. 25, 1946. I pointed out then that such statements represented “at most only a half-truth. . . . For prices are determined not only from the side of supply, but from the side of demand. Demand is now far greater than it was before the war because money incomes are far greater. And money incomes are greater principally

because the supply of money and bank credit has been almost tripled since the outbreak of the war. . . . The solution to the problem of high prices, in brief, is not production alone. It is the production of more goods combined with the cessation of production of more money and bank credit.”

Returning to the subject in *The Times* of May 6, 1946, I wrote: “Unless there is a radical change in our monetary and credit policy, the upward pressure on prices today seems likely to continue for at least several years. . . . The cure for the present inflation is a change in Federal fiscal and money policy, not constant renewals of price control.”

Prices in fact continued to go up, not because price control was taken off, but because the Administration continued to increase the supply of money and credit. At the end of April of this year, the total of demand and time bank deposits and currency outside of banks was \$15,000,000,000 more than at the end of June 1946.

Mr. Truman, in his recent radio address, of course utterly ignored the fact that the upward pressure on prices today comes from his own Administration’s monetary and fiscal policies. And he went on to imply that those who, like himself, favored the price control, were inspired only by the loftiest patriotism, while those who opposed price control were merely “lobbyists,” who “placed private interests above the national interest.”

“After the representatives of the Administration testified in favor of a good, strong law,” he explained, “the Congressional committees heard from 124 witnesses, representing all sorts of private organizations. And do you know how many of them came out for the bill? Twenty, just twenty.” Instead of concluding that this might indicate some possible weaknesses in the bill, or some real dangers to producers and production, Mr. Truman implied that the 104 opposing witnesses were all placing their “private interests above the national interest.”

Mr. Truman’s strange idea is that the only way to be a real friend of the consumer is to make things tough for the producer. But it is a little hard to see just how the consumer gains by measures that discourage production. ☸

## The Cause of Currency Chaos

July 9, 1951

The International Monetary Fund was born in July 1944. One of its declared purposes was “to assist in the establishment of a multilateral system of payments



in respect of current transactions between members and in the elimination of foreign-exchange restrictions." A few weeks ago it issued its second annual report on exchange restrictions. The report concluded that "despite the existing uncertainties and difficulties . . . many countries are in a position to undertake substantial removal of discrimination and relaxation of nondiscriminatory restrictions and to make significant progress toward convertibility."

On the surface this conclusion sounds promising. Yet the full text of the report leaves one with no good reason to believe that progress toward monetary stability and removal of restrictions will be any greater in the next seven years than it has been in the last seven.

For the report is riddled with qualifications, loopholes, and exceptions. For example: "It is the view of the Fund that, if countries have favorable balance of payments conditions and are experiencing increases in their reserves providing a reasonable basis of exchange stability it is in their interest, and in that of the international community, to relax or remove restrictions unless such action would produce conditions justifying the intensification or reintroduction of those restrictions."

More examples: "In certain cases, strategic considerations may well require the retention of control machinery, even if it is not required for financial reasons." "The Fund recognizes that there are a number of countries still experiencing basic or *structural balance of payments difficulties* limiting their ability at this time to make progress toward the removal of restrictions." "It must be recognized, however, that some countries pursuing substantial development plans may not be in a sufficiently strong balance of payments position to permit them to dispense with the selective application of controls."

The sad truth is that the schizophrenia of the Fund—which makes it simultaneously both for and against exchange restrictions—was built into its very conception. In accordance with the theories of the late Lord Keynes, the Fund was established on the assumption that governments can print paper money and fix the value of their monetary unit by simple fiat; and that this rate both can and should be maintained by police coercion. Section 3 of the Articles of Agreement even provides that a member government must not permit exchange transactions to take place within its territory at rates which are different from the parity level.

Other Keynesian theories embodied in the Fund Agreement are that the maintenance of a nation's monetary unit at parity by convertibility into gold on demand is an outworn, needless, or at best a permissible window-dressing requirement; and that the bureaucrats have the

right to alter the exchange value of their nation's monetary unit overnight—thus cheating both domestic and foreign holders of its currency at any time this seems to serve their government's advantage.

Is it any wonder that the end product of these ideas has been increasing currency chaos, an endless series of inflations, a bewildering network of exchange controls which put domestic economies in a straitjacket and disrupt or strangle international trade? The managers of the Fund urge constantly and rightly that all currencies be made freely convertible. But they also want to retain exchange control. Now exchange control and free convertibility are irreconcilable. The way to get free convertibility of currencies is simply to stop prohibiting it—to stop price-fixing in currencies, to stop policing the rates, to stop seizing, licensing, and rationing exchange. But the Fund grants the central principle of exchange control and then deplores all the corollaries.

If we want not merely convertible but stable exchange rates—. Well, some day, somewhere, somebody, even in an official position, may triumphantly rediscover the gold standard. ☼

## Price Fixing as Red Herring

July 16, 1951

The present outlook is for continued inflation and a bad "control" law, but not for the reasons assumed by Administration propaganda. The new law threatens to be bad not because it will give the Administration too few "weapons" to "fight inflation," but because it will give it political weapons it ought not to have at all. And the Administration will still be free to follow inflationary policies.

Says Michael V. DiSalle, head of the Office of Price Stabilization, in fighting the ban against rollbacks: "If all you can do is grant increases, then necessarily your price level will be continuously higher." If this is not a *non sequitur*, it must be because it implies: (1) that the Administration will continue to print more money to force prices up further; (2) that the OPS *must* grant requested increases; and (3) that the intention of the OPS was to grant wage and price increases to favored groups and then hold the index numbers level by forcing price reductions on unfavored groups.

Never before has price control been treated quite so openly and shamelessly in this country as a device for handing out political favors to some groups and penalizing others. A year ago Bernard Baruch recommended



“an overall ceiling across the entire economy,” which would roll back all prices and wages to their level of June 25, 1950. This was economically unsound, but sincere and politically impartial. Among its implications were that everyone should be locked at precisely the income he was already receiving, and that relative profit incentives and deterrents should have been kept just where they were for “peace” production on the day before Korean hostilities broke out.

Hardly anyone seriously advocates this today. Now everyone talks of “correcting inequities.” But how do you determine precisely what constitutes an economic inequity? And how precisely do you measure the extent of the inequity? No one is seriously and openly proposing to legislate an absolute equality of incomes. No one, in fact, has even suggested consistent and coherent economic standards for measuring “inequities.” The standards applied in practice are not economic but political. Where the votes are, there the favors go.

Thus the so-called Wage Stabilization Board raises wages with practically every major decision. Eric Johnston, the Economic Stabilization Administrator, insists that “good reasons” have been shown for every exception that has been made in the so-called wage ceiling. The most favored class next to the wage earners are the farmers, but their political strength is spotty. Congressmen from the city districts want to hold down farm and food prices by edict; congressmen from the rural districts want to boost farm and food prices by “parity” formulas, support prices, and other edicts. Those who are least likely to get price-increase awards in Washington are the landlords and the manufacturing corporations.

What chiefly stands in the way of any serious effort to prevent further inflation is sheer economic illiteracy. It is this that has made it possible for the politicians to blame inflation on “the selfish private interests,” the “greedy sellers,” the “profiteers”—in short, on the producers of the country. The naive faith in price fixing rests on a complete lack of understanding of the function of free markets and the function of relative prices, costs, profits and losses in directing, balancing, synchronizing, and maximizing production. Punitive price fixing pretends to benefit consumers by killing the incentives to production. It pretends to benefit workers by undermining the sources of their employment.

Meanwhile, in the whole hullabaloo about an “anti-inflation” law, no attention whatever is being paid either by the price fixers or by Congress to the real cause of inflation, which is the government-created increase in the quantity of money and credit. Instead of putting

curbs on the money factory—i.e., on the Federal Reserve System—Congress is having its attention diverted to a fraudulent cure for inflation, price fixing. ❁

## Government: Plan Thyself

July 23, 1951

In its budget estimates for the fiscal year 1951 the Administration made a series of bad guesses. The President originally figured that the government would spend \$42,400,000,000, take in \$37,300,000,000, and end up with a deficit of \$5,100,000,000.

This estimate was made in January 1950. Had Mr. Truman foreseen the outbreak of war in Korea that June, his deficit guess would probably have been even larger. Last January, after six months of actual fighting and mobilization, he turned in a revised estimate *reducing* the expected Federal deficit to \$2,700,000,000. Less than three months later this was changed to an expected surplus of \$2,900,000,000. When the fiscal year had actually closed on June 30 last, actual government expenditures had come to \$44,700,000,000, receipts to \$48,000,000,000, and the surplus to \$3,300,000,000.

So in spite of an unexpected year of war, an estimated deficit of \$5,100,000,000 became an actual surplus of \$3,300,000,000. This was an error of \$8,400,000,000—an amount greater than the total average annual expenditures for all purposes in the Roosevelt Administrations prior to the second world war. This huge error merely comes on top of a record of chronic bad guesses. The table below compares, for each year since 1934, the President’s estimates (in millions of dollars) of expenditures, receipts, and deficits for the following fiscal year with the realities of that year.

Even if we disregard the five war years, 1942 to 1946 inclusive, and the wartime year 1951, we find that in the remaining eleven peacetime years there was an average error of 20 percent in estimating expenditures, an average error of 13 percent in estimating revenues, and appalling errors and reversals in estimating surpluses and deficits. In short, a government that presumes to plan and forecast for everybody, cannot even estimate with reasonable accuracy what its own expenditures, revenues, and surplus or deficit are going to be. It cannot predict even its own action, and makes errors of a dimension that would bankrupt a private business in no time.

Fiscal Year	Budget Estimate	Reality	Difference	Fiscal Year	Budget Estimate	Reality	Difference
<b>EXPENDITURES</b>				<b>NET DEFICIT</b>			
1935	\$ 5,961	\$ 6,802	+ 14	1935	\$ 1,986	\$ 3,002	+ 51
1936	7,884	8,477	+ 8	1936	3,892	4,361	+ 12
1937	6,173	8,001	+ 30	1937	519	2,707	+ 422
1938	5,756	7,626	+ 32	1938	1,538 sur.	1,384 def	... ..
1939	6,869	8,707	+ 27	1939	950	3,542	+ 273
1940	8,995	8,998	... ..	1940	3,326	3,611	+ 9
1941	8,424	12,710	+ 51	1941	2,176	5,103	+ 135
1942	17,486	32,397	+ 85	1942	9,211	19,598	+ 113
1943	58,928	78,178	+ 32	1943	42,441	55,897	+ 32
1944	104,128	93,743	- 10	1944	71,047	49,595	- 30
1945	97,954	100,405	+ 2	1945	57,185	53,948	- 6
1946	82,530	63,714	- 23	1946	41,530	20,676	- 50
1947	35,125	42,505	+ 21	1947	3,612 def.	754 sur.	... ..
1948	37,528	33,791	- 10	1948	202 sur.	8,419 sur.	+ 4,068
1949	39,669	40,057	+ 1	1949	4,808 sur.	1,811 def	... ..
1950	41,858	40,156	- 4	1950	873	3,111	+ 256
1951	42,439	44,700	+ 5	1951	5,133 def.	3,300 sur.	... .. ⚙
<b>RECEIPTS</b>							
1935	\$3,975	\$ 3,800	- 4				
1936	3,992	4,116	+ 3				
1937	5,654	5,294	- 6				
1938	7,294	6,242	- 14				
1939	5,919	5,165	- 13				
1940	5,669	5,387	- 5				
1941	6,248	7,607	+ 22				
1942	8,275	12,799	+ 55				
1943	16,487	22,281	+ 35				
1944	33,081	44,148	+ 33				
1945	40,769	46,457	+ 14				
1946	41,255	43,038	+ 4				
1947	31,513	43,259	+ 37				
1948	37,730	42,211	+ 12				
1949	44,477	38,246	- 14				
1950	40,985	37,045	- 10				
1951	37,306	48,000	+ 29				

## Iran vs. Point Four

July 30, 1951

In 1901, the Iranian Government granted, on terms and for a consideration that must have been satisfactory at the time, a concession to what is now the Anglo-Iranian Oil Co. In 1933, Iran granted the company another 60-year concession under which the government got a greatly increased share of profits. A few months ago the Iranian Government repudiated its contract and seized the properties of the company, including its huge installations. The company's value is estimated at \$600,000,000 to \$1,000,000,000.

In the wicked nineteenth century the British Government would probably have sent warships and troops immediately to Iran to protect the lives and property of British citizens. Such action is now universally condemned as "imperialism." So the British, after delays and vacillation, submitted the dispute to the International Court of Justice at The Hague. When the British got a verdict substantially in their favor, however, the Iranians denounced the court and rejected its decision.

What happens now? How does the International Court enforce a decision when a country spurns it? Through the United Nations? Is it likely that the U.N. would order international troops to protect British property? Would any nation besides Britain actually send troops for that purpose? And would not the fatal delays involved in the whole process in fact decide the issue against Britain?

So far as we can see at the moment, the actual result of present procedure is that Britain and the Atlantic Pact nations have lost a vital source of war—strategic oil. Worse, the probabilities seem high that, in one way or another, Iran's oil will now fall under the control of the Kremlin before a year has passed. Stalin will have won another great bloodless victory—bloodless, at least, for the Russians.

The course of our own government in this affair has been peculiar. After the irresponsible Mossadegh had rejected the Hague Court's decision, President Truman sent him an astonishing message. In it he wrote: "You know of our sympathetic interest in this country in Iran's desire to control its natural resources. From this point of view we were happy to see the British Government has on its part accepted the principle of nationalization."

This seems to support the Iranian contention that a government is entitled to sell a concession, invite foreign capital in, then repudiate its contract and seize the capital. It clearly supports the "principle of nationalization"—i.e., the principle of government seizure, ownership, and management, the principle of socialism. And through the Export-Import Bank Mr. Truman has offered the Iranian Government \$25,000,000 to reward its expropriation and to finance its socialistic planning.

In the old days before the Export-Import Bank, ECA, and Point Four, the governments of economically "underdeveloped" countries, like Iran, before joyfully seizing the foreign investments already made there, would have had to reckon with the consequence of an immediate halt to any further significant investment from abroad. But today they can get American Government funds by a simple form of political blackmail. They need merely threaten to seize Western investments, or to bring about a famine by bad policies, or to go Communist, or not to like us.

As long as they have such easy ways of getting money, such governments need not and will not bother to set their economic house in order. They need not fear the usual consequences of breach of faith. Point Four is based on the assumption that what the "backward areas" chiefly need is technical advice. What they really

need is internal political stability, order, and good faith, and the adoption of policies calculated to attract the confidence rather than distrust of domestic as well as foreign private capital. That is why our government foreign give-away and lend-loose programs do not in fact tend to increase world production. On net balance they retard world production and the rise of living standards. ⚙

## The Dangers of Profit Control

August 6, 1951

Nothing in recent years has more clearly signaled the imminent danger to our whole system of private competitive enterprise than a few passages in the President's Midyear Economic Report to Congress.

Mr. Truman assumed the tone of a high authority on economics lecturing to a Congress that would be irresponsible and unpatriotic if it did not adopt without criticism, change, or delay all of the "sound and strong" legislation that he himself is recommending. Yet on Nov. 9, 1946, it was Mr. Truman (as the Mansfield, Ohio, *News-Journal* reminds us) who said: "The law of supply and demand, operating in the market place will, from now on, serve the people better than would continued regulation of prices by the government. . . . Accordingly I have directed immediate abandonment of all controls over wages, salaries, and prices." Whereas on June 14 of this year he declared: "These people who say we should throw out price controls and rent controls are wrong. They are just as wrong now as they were back in 1946."

What is most serious in Mr. Truman's economic report, however, is his proposal for government control of all business profits through discretionary price control. "As a general rule," he declared, "price increases should not be approved, even where some costs have risen, if the industry is earning a fair and equitable level of profits." He added: "Some rollbacks will be needed in selected cases, for example, where prices or profits are excessively high."

Though he himself once failed to make a success of a haberdashery business, Mr. Truman now seems to have taken over the naïve assumption of many labor leaders and bureaucrats that profits are something that occur automatically, and that the chief task of government is to prevent them from becoming "excessive." This ignores the whole way in which a free market and a competitive system work. Profits are never automatic,

never guaranteed, and never uniform. The rate of profit is different for every firm, even within the same industry. In 1947, the latest year for which statistics are available, 169,000 active corporations reported a loss compared with 382,000 that showed a profit.

And the margin of profit does not depend merely on luck. It depends on whether an enterpriser is making a product that consumers really want, and on whether he is making a better or worse product, or making it more efficiently or less, than his competitors. Present and prospective relative profits (and losses) are, in fact, the great guides to production. They determine what commodities and services are produced, exactly *how much* of each of these thousands of different commodities and services is produced, and *how* it is produced. The *differences* between profit margins are both the measure of, and the constant spur to, economy and efficiency. To impose on all firms some bureaucrat's idea of a uniform "fair" profit would be to destroy the whole complex and delicate mechanism of incentives and deterrents which determines the ever-changing balance of production in a private competition system. It would force the substitution of a totalitarian system as crude and clumsy as it would be intolerable.

The President still does not realize that the real cause of inflation is the increase in money and credit brought about by his own policies. He even rebukes the Federal Reserve System for its timid efforts to halt this increase. "General credit measures," he says, "do not discriminate between activities which should be supported, and those which need to be restrained."

The implication of this is that Mr. Truman's political appointees, and not the consumers of the country, should have the right to say what production is good and what is bad, what should be subsidized at the taxpayer's expense, and what should be forbidden. This would be still another way, even more direct than profit control, to give the government life-or-death powers over every firm and business. It would be a long step down the road to economic serfdom. ☸

## Why the New Controls Act Is Bad

August 13, 1951

After his outburst at Detroit, denouncing all criticisms of his policies as "smears," "slander," and "lies" from "doubters and defeatists," neither the tone nor content of Mr. Truman's statement on signing the new economic controls legislation came as any surprise. It was a

purely political document designed to throw the entire blame for any further inflation onto the Republicans in Congress. Take, for example, his comment on the Capehart amendment. "This complicated amendment will force price ceilings up on thousands of commodities, clear across the board. It is like a bulldozer, crashing aimlessly through existing pricing formulas, leaving havoc in its wake." This violent simile was apparently considered a complete substitute for bothering to tell the American people what the Capehart amendment actually provides. It is simply intended to prevent the OPS from fixing price ceilings that would deprive retailers and wholesalers of at least their "customary percentage margin of profit" in the month before the Korean war.

If we accept the premises of price control, it might be argued that this amendment is "inflationary" in the sense that it permits a customary percentage mark-up rather than merely a customary dollars-and-cents mark-up. But this argument is not consistently open to those who, like the President, have supported the cost-of-living escalator clauses in wage contracts.

The new Defense Production Act is really a very bad law, as Mr. Truman insists. But it is bad, in the main, for precisely the opposite reasons from the ones he gives. It is bad not because it has failed to impose price and wage controls that are sufficiently "strong" or "tough," but because it continues the flagrant fraud of price and wage control. It cannot be repeated too often that price control is not a cure for inflation. It regiments the economy and ties it in red tape. It inevitably has consequences which provoke demands for more and more controls and lead toward economic totalitarianism. It actually prolongs and intensifies inflation because it unbalances production and causes shortages—and above all because it diverts public attention away from the only real cause of inflation, which is the increase of money and credit.

In the whole course of the debate on the new law the only genuine anti-inflation amendment that got to a vote was that offered by Rep. Jesse P. Walcott of Michigan. This declared: It is the further intention of the Congress that none of the powers contained in this act . . . with respect to the stabilization of prices and wages, shall be used unless other indirect means of effectuating such controls and stabilization presently provided in other acts for use by the Secretary of Treasury and the Federal Reserve Board have been utilized. . . ." This merely expressed the intention of Congress that *in addition* to using the fraudulent "anti-inflation" measure of price control, government agencies should *also* use the genuine anti-inflation measures involved in raising



discount rates, tightening bank reserves, and in ceasing to monetize the government debt.

But this amendment, the only test of sincere and intelligent anti-inflation sentiment in Congress, was turned down, on almost straight party lines, by a vote of 169 to 149.

And yet there is not an economist worthy of the name who does not know that the basic cause of inflation always and everywhere is an increase in the volume of money and credit. Every congressman, not to speak of Messrs. Truman, DiSalle, and Johnston, would do well to read the *Federal Reserve Bulletin* for July. "Monetary expansion," it begins, "which had been at a very rapid rate in the last half of 1950, was interrupted in the first half of 1951." It is this change, and not any miracle of price control, which slowed down the previous violent rise of wholesale prices. Where these had gone from an index number of 157.3 in June of 1950 to 180.1 in January of this year, they had actually dropped back to 177.9 by the week ended July 31 last. ❁

## Off to the Races

August 20, 1951

On Aug. 3 the Wage Stabilization Board made a recklessly inflationary decision. All wage earners within its jurisdiction are to be allowed to obtain cost-of-living escalator wage increases if "voluntarily" negotiated.

The board showed not the slightest awareness of the disastrous consequences of parallel decisions in Austria and Germany in the '20s. "Those who have forgotten the past," as Santayana has reminded us, "are condemned to repeat it."

Anyone interested in the facts can find them in a book by the Italian economist Costantino Bresciani-Turroni, published in Italy in 1931 and in an English edition, under the title *The Economics of Inflation*, in 1937 (London: Allen and Unwin). "It was observed in Austria as well as in Germany," writes Bresciani-Turroni, "that the inflation proceeded with quickened pace especially after the workers had obtained money wages which varied with the index number of the cost of living." This is an understatement. The system of fixing wages on a cost-of-living index became general in the summer of 1923. The cost-of-living index number in Germany rose from 3,816 in May of 1923 to 7,650 in June, 37,651 in July, 586,045 in August, 15,000,000 in September. . . .

This consequence was not merely coincidental. As I wrote (*Newsweek*, June 7, 1948) when the General

Motors wage settlement was first announced which established the "cost-of-living adjustment" as a precedent here: "We must remember that the consumers' price index represents an *average* of many different prices. If companies whose products have risen in price much less than the average were nonetheless compelled to pay wage increases equal to the average, they would either be forced out of business or forced to raise prices. If the price index were thus forced up, this would of course in turn require still further upward cost-of-living wage adjustments."

George W. Taylor, chairman of the Wage Stabilization Board, has tried to defend the new decision by saying: "If prices are stabilized there will be very little movement in wage rates under our cost-of-living resolution." This has surface plausibility, but it is not true. If each particular wage is allowed to catch up with the existing average percentage rise in wages or in prices generally, then the average wage itself must go up.

This points to the fallacy in all the so-called "catch-up" wage formulas. They force an increase in production costs of goods that have hitherto not had the average price rise; hence they lead to demands for price relief. They force firms to borrow more money at the banks to meet increased payrolls. This increases the money-and-credit supply. Increased money in the hands of workers bids for a reduced volume of civilian goods. The increases thus forced in the price of goods become in turn the cause under the escalator provision for still further increases in wages—and so *ad infinitum*.

The attempt is already being made to argue that this universalized escalator clause was made necessary in wages to compensate for the action of Congress in allowing price increases to meet increased costs under the Capehart amendment. This defense puts Capehart before the horse. Congress passed the amendment because it was convinced that wages were not going to be stabilized anyway. It felt that increased wage costs must therefore be permitted to come through in prices. Continuance of existing wage escalator clauses had *already* been sanctioned by Eric Johnston months before the Defense Production Act came up for renewal. Every realist recognized that this discrimination as between different labor groups could not and would not be long maintained.

But Congress made the wrong response. Instead of insisting on catch-up price-fixing to match catch-up wage-boosting, Congress should have allowed price- and wage-fixing powers to expire altogether, and concentrated on the only real cure of inflation, which was

to pass laws designed to halt the further increase in money and credit. ❁

## Congress's Monetary Duty

August 27, 1951

The renewed Defense Production Act, with its emphasis on price control, is a fraudulent remedy for inflation. The only genuine anti-inflation proposal that even got to a vote in connection with it was the amendment offered by Rep. Jesse P. Wolcott. This amendment—which would have put pressure on the Treasury and Federal Reserve Board to start using the real anti-inflationary powers that they have long possessed—was defeated by virtually a straight party vote. In the Senate the matter was never even brought up. As a result we now have on the books a so-called anti-inflation measure unmarred by a single clause calculated to halt inflation.

There is only one way to stop inflation. That is to stop the further increase in the supply of money and credit. Congress has not only the *right* to regulate money and credit, but the clear constitutional *duty* to do so. One of the enumerated powers of Congress (not of the President) is “to coin money” and “regulate the value thereof.”

Now the value of our present money is not stable—precisely because Congress has neglected its clear duty. It has delegated excessive discretionary powers to the executive and to his appointed officials, and it has done this at the request of these officials.

The original Federal Reserve Act provided that the Federal Reserve Banks must hold a reserve in gold and lawful money of 35 percent against deposits and 40 percent against notes. On June 12, 1945, under the plea of the Federal Reserve authorities that further inflation might be necessary, Congress reduced the required legal reserves of the Federal Reserve Banks to only 25 percent against deposit and note liabilities combined. Germany had already surrendered a month before. Hostilities against Japan ended less than three months later. Yet the Federal Reserve authorities have never requested that the former Federal Reserve ratios be restored, and Congress has never restored them. The duty of Congress is plain. It must restore the required legal reserves of the Federal Reserve Banks to their former level. It must do this whether or not the Federal Reserve authorities request it or even if they actively combat it; for there is almost no case on record in which a Federal agency has asked for *limitations* on its own powers or discretion. In fact, because of the

Administration's present irresponsible course, it is desirable that Congress:

1—Restore the minimum legal reserve ratio of the Federal Reserve Banks from the present 25 percent to at least 35 percent against combined deposit and note liabilities.

2—Authorize the Federal Reserve Board to raise the legal reserve requirement to 40 percent—and even (as an emergency measure) as high as the actual reserve ratio existing at the time of the Board order. Such a power would make the Federal Reserve Board itself clearly responsible for any further failure to halt inflation. And it would provide a conclusive answer to those who have been opposing a restoration of the former Federal Reserve Bank legal reserve requirements on the incredibly confused ground that even this restoration would still allow further inflation. Of course it would; but it would allow far *less* further inflation than the present legal requirement. And if Congress in addition empowered the Board to raise the legal reserve ratio of the Federal Reserve Banks as high as their actual reserve ratio at the time of the order, then the responsibility for further inflation would be clearly upon the Board.

3—Authorize the Reserve authorities to raise the legal reserve requirements of *member* banks as high as their already existing reserve ratios. But only if (a) reserve requirements of the Federal Reserve Banks have already been raised to at least 40 percent and (b) if Reserve Bank required ratios have also been frozen where they are. In short, the Federal Reserve authorities should no longer be permitted to exempt their own goose while they tie up the other fellow's gander. Especially as new Federal Reserve credit is the reserve basis for new member-bank credit, and hence many times as inflationary. ❁

## Inflation for Beginners—I

September 3, 1951

No subject is so much discussed today—or so little understood—as inflation. The politicians in Washington talk of it as if it were some horrible visitation from without, over which they had no control—like a flood, a foreign invasion, or a plague. It is something they are always promising to “fight”—if Congress or the people will only give them the “weapons” or “a strong law” to do the job.

Yet the plain truth is that our political leaders have brought on inflation by their own money and fiscal

policies. They are promising to fight with their right hand the conditions they have brought on with their left.

Inflation, always and everywhere, is primarily caused by an increase in the supply of money and credit. In fact, inflation *is* the increase in the supply of money and credit. If you turn to the recent American College Dictionary, for example, you will find the first definition of inflation given as follows: “Undue *expansion* or increase *of the currency* of a country, esp. by the issuing of paper money not redeemable in specie.”

In recent years, however, the term has come to be used in a radically different sense. This is recognized in the second definition given by the American College Dictionary: “A substantial *rise of prices* caused by an undue expansion in paper money or bank credit.” Now obviously a rise of prices caused by an expansion of the money supply is not the same thing as the expansion of the money supply itself. A cause or condition is clearly not identical with one of its consequences. The use of the word “inflation” with these two quite different meanings leads to endless confusion.

The word “inflation” originally applied solely to the quantity of money. It meant that the volume of money was *inflated*, blown up, overextended. It is not mere pedantry to insist that the word should be used only in its original meaning. To use it to mean “a rise in prices” is to deflect attention away from the real cause of inflation and the real cure for it.

Let us see what happens under inflation, and why it happens. When the supply of money is increased, people have more money to offer for goods. If the supply of goods does not increase—or does not increase as much as the supply of money—then the prices of goods will go up. Each individual dollar becomes less valuable because there are more dollars. Therefore more of them will be offered against, say, a pair of shoes or a hundred bushels of wheat than before. A “price” is an *exchange ratio* between a dollar and a unit of goods. When people have more dollars, they value each dollar less. Goods then rise in price, not because goods are scarcer than before, but because dollars are more abundant.

In the old days, governments inflated by clipping and debasing the coinage. Then they found they could inflate cheaper and faster simply by grinding out paper money on a printing press. This is what happened with the French *assignats* in 1789, and with our own currency during the Revolutionary War. Today the method is a little more indirect. Our government sells its bonds or other IOU’s to the banks. In payment, the banks create “deposits” on their books against which the government

can draw. A bank in turn may sell its government IOU’s to the Federal Reserve Bank, which pays for them either by creating a deposit credit or having more Federal Reserve notes printed and paying them out. This is how money is manufactured.

The greater part of the “money supply” of this country is represented not by hand-to-hand currency but by bank deposits which are drawn against by checks. Hence when most economists measure our money supply they add demand deposits (and now usually, also, time deposits) to currency outside of banks to get the total. The total of money and credit so measured was \$64,099,000,000 at the end of December 1939, and \$174,200,000,000 at the end of June this year. This increase of 171 percent in the supply of money is overwhelmingly the main reason why wholesale prices rose 135 percent from 1939 to June of this year. ⚙

## Inflation for Beginners—II

September 10, 1951

It is often argued that to attribute inflation solely to an increase in the volume of money is “oversimplification.” This is true. Many qualifications have to be kept in mind.

For example, the “money supply” must be thought of as including not only the supply of hand-to-hand currency, but the supply of bank credit—especially in the U.S., where most payments are made by check. And it is an oversimplification to say that the value of an individual dollar depends simply on the *present* supply of dollars outstanding. It depends also on the *expected future* supply of dollars. If most people fear, for example, that the supply of dollars is going to be even greater a year from now than at present, then the present value of the dollar (as measured by its purchasing power) will be lower than the present quantity of dollars would otherwise warrant.

Again, the value of any monetary unit such as the dollar, depends not merely on the *quantity* of dollars but on their *quality*. When a country goes off the gold standard, for example, it means in effect that gold, or the right to get gold, has suddenly turned into mere paper. The value of the monetary unit therefore usually falls immediately, even if there has not yet been any increase in the quantity of money. This is because the people have more faith in gold than they have in the promises or judgment of the government’s monetary managers. There is hardly a case on record, in fact, in



which departure from the gold standard has not soon been followed by a further increase in bank credit and in printing-press money.

In short, the value of money varies for basically the same reasons as the value of any commodity. Just as the value of a bushel of wheat depends not only on the total present supply of wheat but on the expected future supply and on the quality of the wheat so the value of a dollar depends on a similar variety of considerations. The value of money, like the value of goods, is not determined by merely mechanical or physical relationships, but primarily by psychological factors, which may often be quite complicated.

In dealing with the causes and cure of inflation, it is one thing to keep in mind real complications; it is quite another to be confused or misled by needless or nonexistent complications. For example, it is frequently said that the value of the dollar depends not merely on the quantity of dollars but on their “velocity of circulation.” Increased “velocity of circulation,” however, is not a cause of a further fall in the value of the dollar; it is itself one of the consequences of the fear that the value of the dollar is going to fall. (Or, to put it the other way round, of the belief that the price of goods is going to rise.) It is this belief that makes people more eager to exchange dollars for goods. The emphasis by some writers on “velocity of circulation” is just another example of the error of substituting dubious mechanical for real psychological reasons.

Another blind alley: in answer to those who point out that inflation is primarily caused by an increase in money and credit, it is contended that the increase in commodity prices often occurs *before* the increase in the money supply. This is true. This is what happened immediately after the outbreak of war in Korea. Strategic raw materials began to go up in price on the fear that they were going to be scarce. Speculators and manufacturers began to buy them to hold for profit or protective inventories. *But to do this they had to borrow more money from the banks.* The rise in prices was accompanied by an equally marked rise in bank loans and deposits. From May 31, 1950, to May 30, 1951, the loans of the country’s banks increased by \$12,000,000,000. If these increased loans had not been made, and new money (some \$6,000,000,000 by the end of January 1951) had not been issued against the loans, the rise in prices could not have been sustained. The price rise was made possible, in short, only by an increased supply of money. ❁

## Inflation for Beginners—III

September 17, 1951

One of the most stubborn fallacies about inflation is the assumption that it is caused, not by an increase in the quantity of money, but by a “shortage of goods.”

It is true that a *rise in prices* (which, as we have seen, should not be identified with inflation) can be caused *either* by an increase in the quantity of money or by a shortage of goods—or partly by both. Wheat, for example, may rise in price either because there is an increase in the supply of money or a failure of the wheat crop. But we seldom find, even in conditions of total war, a *general* rise of prices caused by a *general* shortage of goods. Yet so stubborn is the fallacy that inflation is caused by a “shortage of goods,” that even in the Germany of 1923, after prices had soared hundreds of billions of times, high officials and millions of Germans were blaming the whole thing on a general “shortage of goods”—at the very moment when foreigners were coming in and buying German goods with gold or their own currencies at prices lower than those of equivalent goods at home.

The rise of prices in the United States since 1939, or since the outbreak of war in Korea, is constantly being attributed to a “shortage of goods.” Yet official statistics show that our rate of industrial production in June of this year, for example, was two and a quarter times as much as from 1935 to 1939, and 12 percent higher than in June of 1950. Nor is it any better explanation to say that the rise in prices is caused by a shortage in civilian goods. Even to the extent that *civilian* goods were really short, the shortage would not cause a rise in prices if taxes took away as large a percentage of civilian income as rearmament took of civilian goods.

This brings us to another source of confusion. People frequently talk as if a budget deficit were in itself both a necessary and a sufficient cause of inflation. A budget deficit, however, if fully financed by the sale of government bonds paid for out of real savings, need not cause inflation. And even a budget surplus, on the other hand, is not an assurance against inflation. This was shown in the fiscal year ended June 30, when there was substantial inflation *in spite of* a budget surplus of \$3,500,000,000. A budget deficit, in short, is inflationary only to the extent that it causes an increase in the money supply. And inflation can occur even with a budget surplus if there is an increase in the money supply notwithstanding.

The same chain of causation applies to all the so-called “inflationary pressures”—particularly the so-called “wage-price spiral.” If it were not preceded,



accompanied, or quickly followed by an increase in the supply of money, an increase in wages above the “equilibrium level” would not cause inflation; it would merely cause unemployment. And an increase in prices without an increase of cash in people’s pockets would merely cause a falling off in sales. Wage and price rises, in brief, are usually a *consequence* of inflation. They can *cause* it only to the extent that they force an increase in the money supply.

The accompanying chart compares the percentage increase in the money supply (currency plus bank deposits) since 1939 with the rise in wholesale prices and in the cost of living during the same period. The correlation is obvious—though the factors involved are too complex to expect it to be exact. The chief reason why prices have not increased as much as the money supply is that the production rate of goods has also greatly increased since 1939.

A warning must also be given concerning the accuracy of the two price indexes themselves. They show apparent stability from the end of 1942 to the middle of 1946, and a sharp rise then when price control was taken off. But this is chiefly because official price and cost-of-living indexes tend to become fictional under price control. They do not measure the realities of black market prices, shortages, rationing, queues, favoritism, deterioration of quality and non-existent goods. When price control is taken off, the government’s increase of the money supply has its full effect on the official price indexes. ❀

## Inflation for Beginners—IV

September 24, 1951

As long as we are plagued by false theories of what causes inflation, we will be plagued by false remedies. Those who ascribe inflation primarily to a “shortage of goods,” for example, are fond of saying that “the answer to inflation is production.” But this is at best a half-truth. It is impossible to bring prices down by increasing production if the money supply is being increased even faster.

The worst of all false remedies for inflation is price fixing and wage fixing. For if more money is put into circulation, while prices are held down, most people will be left with unused cash balances seeking goods. The final result, barring a like increase in production, must be higher prices.

There are broadly two kinds of price fixing—“selective” and “overall.” With selective price fixing the government tries to hold the prices merely of a

few strategic war materials or a few necessities of life. But then the profit margin in producing these things becomes lower than the profit margin in producing other things, including luxuries. So “selective” price fixing quickly brings about a shortage of the very things whose production the government is most eager to encourage. Then bureaucrats turn to the specious idea of an overall freeze. They talk of holding or returning to the prices and wages that existed on the day before war broke out in Korea. But the price level and infinitely complex price and wage interrelationships of that day were the result of the state of supply and demand on that day. And supply and demand seldom remain the same, even for the same commodity, for two days running, even without major changes in the money supply.

It has been moderately estimated that there are some 9,000,000 different prices in the United States. On this basis we begin with more than 40 trillion interrelationships of these prices. And a change in one price always has repercussions on a whole network of other prices. The prices and price relationships of June 24, 1950, were presumably those roughly calculated to encourage a maximum balanced production of *peace time* goods. They are obviously the wrong prices and price relationships to encourage the maximum production of *war* goods. Moreover, the price pattern of a given day always embodies many misjudgments and “inequities.” No single mind, and no bureaucracy, has wisdom and knowledge enough to correct these. Every time a bureaucrat tries to correct one price or wage maladjustment or “inequity” he creates a score of new ones. And there is no precise standard for measuring the economic “inequities” of a particular case that any two people seem able to agree on. Coercive price fixing would be an insoluble problem, in short, even if those in charge of it were the best-informed economists, statisticians, and businessmen in the country, and even if they acted with the most conscientious impartiality. But they are subjected in fact to tremendous pressure by the organized pressure groups. Those in power soon find that price and wage control is a tremendous weapon with which to curry political favor or to punish opposition. That is why “parity” formulas are applied to farm prices and escalator clauses to wage rates, while industrial prices and rents are penalized.

Another evil of price control is that, though it is always put into effect in the name of an alleged “emergency,” it creates powerful vested interests and habits of mind which prolong it or tend to make it permanent. Outstanding examples of this are rent control and exchange control. Price control is the major step toward a fully regimented or “planned” economy. It

causes people to regard it as a matter of course that the government should intervene in every economic transaction.

But finally, and worst of all from the standpoint of inflation, price control diverts attention away from the only real cause of inflation—the increase in the quantity of money and credit. Hence it prolongs and intensifies the very inflation it was ostensibly designed to cure. ❀

## Inflation for Beginners—V

October 1, 1951

The cure for inflation, like most cures, consists chiefly in the removal of the cause. The cause of inflation is the increase of money and credit. The cure is to stop increasing money and credit. The cure for inflation, in brief, is to stop inflating. It is as simple as that.

But while simple in principle, this cure often involves complex and disagreeable decisions on detail. Let us begin with the Federal budget. It is next to impossible to avoid inflation with a continuing heavy deficit. That deficit is almost certain to be financed by inflationary means—that is, by directly or indirectly printing more money. Huge government expenditures are not in themselves inflationary—provided they are made wholly out of tax receipts, or out of borrowing paid for wholly out of real savings. But the difficulties in either of these methods of payment, once expenditures have passed a certain point, are so great that there is almost inevitably a resort to the printing press.

Moreover, though huge expenditures wholly met out of huge taxes are not necessarily *inflationary*, they inevitably reduce and disrupt production, and undermine any free enterprise system. The remedy for huge governmental [deficits] is therefore not equally huge taxes, but a halt to reckless spending.

On the monetary side, the Treasury and the Federal Reserve System must stop creating artificially cheap money. That is, they must stop arbitrarily holding down interest rates. And they must stop buying at par the government's own bonds. When interest rates are held artificially low, they encourage an increase in borrowing. This leads to an increase in the money and credit supply. The process works both ways—for it is necessary to increase the money and credit supply in order to keep interest rates artificially low. That is why the “cheap money” policy and the government-bond-support policy are simply two ways of describing the same thing. As long as Federal Reserve Banks buy the government's 2½ percent bonds, say, at par, they hold down the basic long-term interest rate to 2½ percent. And they pay

for these bonds, in effect, by printing more money. This is what is known as “monetizing” the public debt. Inflation will go on as long as this goes on.

The Federal Reserve System, if it were determined to halt inflation and to live up to its responsibilities, would not only halt this process of holding down interest rates and monetizing the public debt, but it would take the leadership in *raising* interest rates. It should never have departed, in fact, from the tradition that the discount rate of the central bank should normally (and above all in an inflationary period) be a “penalty” rate—that is, a rate higher than the member banks themselves get on their loans.

Congress should immediately restore the required legal reserve ratio of the Federal Reserve Banks to the previous level of 35 and 40 percent, instead of the present “emergency” level of 25 percent put into effect as a war-inflation measure in June, 1945. Congress should in addition *authorize* the Federal Reserve Board to increase this reserve ratio even further. Legal minimum reserve ratios are admittedly an awkward method of limiting the potential supply of money and credit. But they are an added safeguard when other methods are not properly used. As long as the Federal Reserve authorities, moreover, insist on the power to control the reserve ratios of member banks, they should also be obliged to control their own. An increase in reserve bank credit can cause far more inflation than an equal increase in member bank credit.

As a last resort the monetary authorities could actually freeze the credit supply, allowing no net increase in loans at all. But this will never be necessary if other measures have been wisely taken.

It can be said, finally, that the world will never work itself out of the present inflationary era until it returns to the gold standard. The gold standard provided a practically automatic check on internal credit expansion. That is why the bureaucrats abandoned it. In addition to its being a safeguard against inflation, it is the only system that has ever provided the world with the equivalent of an international currency.

The first question to be asked today is not *how* can we stop inflation, but do we really *want* to? For one of the effects of inflation is to bring about a redistribution of wealth and income. In its early stages (until it reaches the point where it grossly distorts and undermines production itself) it benefits some groups at the expense of others. The first groups acquire a vested interest in maintaining inflation. Too many of us continue under the delusion that we can beat the game—that we can increase our own incomes faster than our living costs. So there is a great deal of hypocrisy in

the outcry against inflation. Many of us are shouting in effect: "Hold down everybody's price and income except my own."

Governments are the worst offenders in this hypocrisy. At the same time as they profess to be "fighting inflation" they are following a "full employment" policy. And as one writer recently admitted frankly in the London *Economist*: "Inflation is nine-tenths of *any* full-employment policy."

What he forgot to add is that inflation must always end in a crisis and a slump, and that worse than the slump itself may be the public delusion that the slump has been caused, not by the previous inflation, but by the inherent defects of "capitalism."

Inflation, to sum up, is the increase in the volume of money and bank credit in relation to the volume of goods. It is harmful because it depreciates the value of the monetary unit, raises everybody's cost of living, imposes what is in effect a tax on the poorest at as high a rate as the tax on the richest, wipes out the value of past savings, discourages future savings, redistributes wealth and income wantonly, encourages and rewards speculation and gambling at the expense of thrift and work, undermines confidence in the justice of a free enterprise system and corrupts public and private morals.

But it is never "inevitable." We can always stop it overnight, if we have the sincere will to do so. ❁

## The Real Problems of France

October 8, 1951

PARIS—To a visitor who, like myself, has not been in France since 1947, the improvement in the physical appearance of the country, and in the better neighborhoods of the cities, is in some respects striking. Much of this physical improvement must no doubt be attributed directly or indirectly to American economic aid. Yet the EGA program, as at present conceived and administered, seems largely irrelevant to the real problems that confront France today. These problems might be grouped under three main headings: (1) lack of confidence in the government, (2) lack of confidence in the currency, and (3) lack of incentives for new enterprises and for expanding production.

1—When a Frenchman talks about necessary fiscal or economic reforms, he is apt to add resignedly that they would only be possible under a government with a majority dependable enough to give it reasonable security of tenure and courage. But the French vote for a multiplicity of warring political parties and become

collectively disgusted with the overall situation they have collectively created.

Much has been written about the great effect of Marshall aid in turning the tide against Communism in Europe. In France, the statistical proof is not impressive. In November 1946, the Communist vote came from 28.6 percent of the French electorate. In the elections this June the percentage was still 26.5. How much credit Marshall aid can claim even for this reduction of only 2 percentage points is doubtful. For in the light of all that has happened in the intervening four years, no French voter has any excuse for still believing the old myth that Soviet Russia is a great peace-loving nation or that the French Communist Party has the interests of France primarily at heart.

2—The Frenchman's lack of confidence in his currency is hardly surprising. He has seen the franc decline to one-twentieth of its purchasing power in 1938. He has seen it decline since 1914 to one-seventieth of its former value in terms of the dollar and to less than one-hundredth of its former value in terms of gold. No one should be astonished to learn that the former French habits of saving have largely disappeared and that the kind of saving that does take place is more likely to go into gold-hoarding than into government bonds.

Today the franc is under new pressure of several different kinds. One is the rise in world raw material prices, owing to American rearmament. Another is the increased strain on the budget for increased French armament. A third is the continuing deficit in French socialized industries (of more than 90,000,000,000 francs, for one example, in the nationalized railways in the 1951 fiscal year). A fourth is the political pressure for adopting "l'échelle mobile" —"the moving ladder," or sliding scale, whereby the legal minimum wage will automatically follow prices upward. A fifth is the persistence of a low-interest-rate policy under which the volume of money and bank credit have continued to expand by 554,000,000,000 francs, for example, from June 1950 to May of this year.

3—Finally, as a result of the whole network of exchange controls, import quotas, tariffs, price controls, allocations, social-security deductions and payments on a huge scale, and the cartelization of business, there has been a great distortion of productive incentives, a growing lack of correspondence between effort and reward, and heavy obstacles to the appearance or success of new enterprises.

I have space to cite only one example. Price-fixing in wheat is unfortunately one of the chief reasons why France's wheat production since the war has been persistently lower than the average production in 1934–38.



The major problems of France today, in short, barring the menace of Russia, are problems of internal policy. They can be lightened, of course, by continuance of American military and economic aid. But they can be solved only by a courageous recognition on the part of the French that a halt to the present inflation, and the restoration of economic freedom and production, will come primarily only through their own efforts. ❁

## To a Mitigated Socialism

October 15, 1951

LONDON—Even if, in accordance with most forecasts, the Conservatives win this month's elections, the outlook at the moment is not very promising for a return in England to a free-enterprise system as Americans still use the term. What seems much more likely is a mitigated socialism, administered by the very people who declare that they do not believe in socialism.

There are many bold and excellent phrases in the Conservative manifesto: "The attempt to impose a doctrinaire Socialism upon an island which has grown great and famous by free enterprise has inflicted serious injury upon our strength and prosperity. . . . Freedom and abundance—these must be our aims. . . . Confidence and currency are interdependent. . . . The Conservative aim is to increase our national output." And so on. But when it comes to details, the manifesto promises merely not to carry socialism any further. The Conservatives, in effect, promise to operate existing socialism much better than those who introduced it.

The Conservative manifesto does promise definitely to "stop all further nationalization." This means repeal of the law to nationalize steel. But the manifesto also promises that "coal will remain nationalized"—though the Conservatives have been repeatedly asserting that coal nationalization has been an utter failure. Quite as important as what the manifesto says is what it does not say. It says nothing about denationalizing the railroads, nothing about denationalizing gas and electricity, nothing about denationalizing telephone and telegraph service, nothing about denationalizing the Bank of England, and nothing about abandoning the National Health Scheme or exchange control. It merely promises to run a few of these schemes more efficiently, to "simplify" and "decentralize" administration, and to "prune waste and extravagance."

In some respects the Conservatives even try to outbid the Labour Party in socialism, statism, protectionism, and restrictionism. "Housing," they declare, "is the first of the social services." And they offer a "target"

of 300,000 (mainly government-built) houses a year, compared with Labour's 200,000. They promise to maintain "guaranteed agricultural prices and markets and protect British horticulture from foreign dumpers." They warn that: "Food subsidies cannot be radically changed in present circumstances." And they call for an excess-profits tax—which is hardly calculated to encourage new firms, efficiency, or increased output.

On their side the Labourites contrast the "mass unemployment, mass fear, and mass misery" under the Conservatives in the inter-war years with the miracle of "full employment" that they have brought about. They support this with statistics that are very impressive if taken at face value.

Why, then, are most British voters nonetheless expected to vote Conservative on Oct. 25? One reason, of course, is that they will not be voting on economic issues alone: Many are disgusted by what they regard as the humiliating conduct of the government in the Iranian crisis, for example. Another reason is that, though the Conservatives do not promise them release from socialism, they at least promise not to believe in it, while the Labourites threaten to make it even worse. They threaten to "take over concerns which fail the nation and start new public enterprises wherever this will serve the national interest"; to "limit dividends by law"; to put still more punitive taxation "on the small minority who own great fortunes," and to "stop all excess profits"—whatever that may mean. (Incidentally, the Labour manifesto's boast of economic achievements gives not a single line of credit to American aid.)

But one of the chief reasons why many will vote Conservative does not reflect a flattering estimate of the party's candor. These voters suspect that the Conservatives, particularly if they get a substantial majority in the new Parliament, will proceed to liquidate socialism to a larger extent than they now dare to promise. But whether the Conservatives are in fact prepared ideologically to do this is still an open question. ❁

## Britain's 'Third Crisis'

October 22, 1951

LONDON—On Oct. 3 the British public received the jolting news that the gold and dollar reserves of the sterling area had fallen in July, August, and September by \$598,000,000. This loss of gold was greater than that in the entire six months before the 1949 devaluation. As T.W. Kent wrote in *Lloyds Bank Review*, "the change is almost the most startling of all the dramatic turns in Britain's postwar economic experience."



One of the most illuminating analyses of the causes of these recurring British crises is that made recently in *The Manchester Guardian* by the well-known statistician Colin Clark (*Newsweek*, Oct. 1), "Not merely the British Government," he declares, "but virtually the whole British people . . . has allowed itself to cherish three economic illusions"—the illusions of Cheap Food, of Limitless Taxable Capacity, and of Rapidly Increasing Productivity.

The illusion of cheap food, according to Clark, consists in the belief that the recent adverse movement of the "terms of trade" is temporary and that Britain will soon be able again to buy its imports cheaper and to sell its exports dearer. Clark shows convincingly that this belief rests on nothing better than wishful thinking.

His next point concerns taxable capacity. In each postwar year British national and local taxation has been levied at a rate of more than 40 percent of the national income. "In no other country has a rate like this ever been approached." As early as 1945 Clark contended that the safe limit of taxation was 25 percent of the national income. "This result was based not upon theoretical considerations, but upon a study of the actual experience of attempts which had been made at various times and places, to exceed this limit. In every case the effects were so discouraging to real production, and encouraging to the circulation of money, that within two or three years an inflation supervened sufficient to raise prices (and thus the money value of national income) to a point where the 25 percent ratio again prevailed." Clark concludes that unless drastic and immediate steps are taken to slash British Government expenditures the present "temporary barriers" to inflation "will shortly all be swept away."

This conclusion is of course not "scientific." But it is based on impressive experience. A number of economists in England, in fact, have come independently to the conclusion that taxation is already so high that more of it will not combat inflation because it will so seriously reduce the incentives to hard work, risk taking, and enterprise. This conclusion has a direct bearing on our inflation problem at home. Only drastic slashes in governmental spending can help.

The third economic illusion in Britain, according to Clark, is the belief that British productivity has been increasing at an unprecedented rate. He questions the official claims that real product (not money product) has been increasing at the rate of 5 percent per annum. His own conclusion is that real product per man-hour is rising very slowly and is only about 5 percent higher

than that of 1938. About half of this increase, moreover, has been swallowed up in shorter working hours. This conclusion is supported by the London and Cambridge Economic Service, which argues that the rate of increase in real product may now be very small. It is supported also by what is known in special fields. The Girdwood committee estimated in 1950, for example, that to build a given type of house in England the man-hours needed in 1949 were 26 percent above the level of 1938–39—a 20 percent *drop* in productivity.

Colin Clark, in short, has correctly put his finger on three of the economic illusions that have led to persistent financial crises in Great Britain. But there are many others. He has not put his finger on the central illusion, from which most of the rest are derived. This is that England can be saved by a series of governmental controls. The truth is that these very controls—and above all exchange control—create the evils they are ostensibly designed to combat. ☼

## This Is Where We Came In

October 29, 1951

When I was in Paris a few weeks ago the press was headlining what it called "*l'opération bifteck*"—the government's order rolling back meat prices by 10 percent. The result, of course, was a meat shortage.

To an American it was all very familiar. When President Truman restored meat ceilings in September 1946, the Federally inspected production of beef, which had been 594,000,000 pounds in August, fell to 186,000,000 in September (only 28 percent of production in the preceding September). Mr. Truman belatedly removed ceilings on Oct. 14, and in November beef production was back to 605,000,000 pounds.

Yet our price controllers seem incapable of learning even from our own experience. They seem determined to repeat and magnify every past error. They have raided hundreds of slaughtering plants and succeeded in bringing about another beef "shortage." The American Meat Institute reports that in the four-month period of June through September, the 95 leading beef-producing plants were able to buy only 65 percent of the number of cattle they bought in the corresponding period of 1950. At the ceiling prices they were legally allowed to bid, they weren't being offered any more. Yet in the same four months the receipts of cattle at the twelve leading livestock markets were down only 12 percent compared with the corresponding 1950 period.

What became of the cattle that were not bought by the 95 leading beef-producing plants? It's a fair assumption that they went through gray-or black-market processors. If these processors are not paying much attention to official ceiling prices, will they pay much attention to the slaughtering quotas that Michael DiSalle has been demanding? Suppose DiSalle got his slaughtering quotas. And suppose even that he was able to enforce them. The first consequence would be sharply reduced competition among packers. (There are more than 3,000 plants.) The efficient packer could not expand, because the quota assignment would not permit him to. New entrants would be presumably barred. The inefficient packer could not be eliminated, because he would be assured of his quota. Incentives to better service and competitive cost-cutting—which help both cattle raisers and consumers—would languish or disappear.

To the extent that the OPS really did prevent black-market operations, it would repeat the 1946 shortage of meat. For by holding meat below the market price, it would both encourage increased meat consumption and discourage meat production. If DiSalle sincerely believes that he can hold meat prices substantially below free-market levels for any length of time without resorting to consumer rationing and eventually to subsidies, then he does not understand the tremendous task he is undertaking.

In *Newsweek* of Nov. 29, 1948, reporting on a visit to the stockyards of Fort Worth, I tried to explain why any effort to fix meat prices was bound to derange production: "It is the present *relative* prices of meat in the butcher shops to meat on the hoof, of hogs to corn, of corn to hay and wheat, of hay and corn to steers, of steers to calves, hogs, and sheep . . . it is this incredibly intricate maze of relationships which determines how much corn and wheat will be planted, how many hogs will be raised, how many steers will be slaughtered now, how many held for further feeding, whether on ranges or in pens, for just how long, to just what weights, and so on. . . . The intimate connexity of prices runs through the whole economy. It is the relation of the prices of thousands of different commodities to each other that determines the relative amounts produced of each of these commodities. It is not surprising, in view of these intricate interrelationships, that government price-fixing always upsets the balance of production."

The worst of all excuses for price-fixing, we may add now, is "fighting inflation." Price-fixing is a futile but harmful effort on the part of the government to protect the public against the high prices caused by its own overissue of money and credit. ☸

## Chaotic Spending and Taxing

November 5, 1951

The history and contents of the new tax law are one more illustration of what is wrong with our whole budgetary system.

It was irresponsible and hypocritical for the House to vote for colossal appropriations and then try to reject the taxes to meet the appropriations. It was irresponsible for Congress to make these appropriations and then pass a tax law calculated to leave a deficit of more than \$6,000,000,000 in the current fiscal year, and an estimated \$18,000,000,000 to \$24,000,000,000 in the next fiscal year. In combination these fiscal actions were recklessly inflationary.

So far the critics of Congress are right. But when they go on, as most of them do, to support Mr. Truman's lip-demand for \$5,000,000,000 to \$10,000,000,000 of still further taxes, they are closing their eyes to the facts. These further sums simply cannot be raised (at present price levels) without irreparable harm to the American economy.

Taxes are now scraping the bottom of the barrel. In the highest brackets of the personal income tax the rates long ago passed the point of maximum productivity. Today they reflect mainly an attempt to punish success. It has already been pointed out in *Newsweek* that a 100 percent tax on all taxable incomes above \$25,000—that is, complete confiscation—would yield only \$700,000,000 a year more in revenue, while a similar tax on all taxable incomes above \$10,000 would yield only about \$3,500,000,000. But even these represent the maximum possible yields, on the assumption that people would be foolish enough to go on earning what they could not keep.

Corporation tax rates now reach 52 percent on corporate incomes, plus 82 percent on so-called excess profits, with a maximum overall rate of 70 percent. Just look at that as an incentive to start new corporate enterprises, to put more capital into old ones, and to expand the capital equipment upon which the growth of all production, the creation of new employment and the increase of all real wages depends. The government takes up to 70 percent of a corporate investor's earnings on his investment before he even gets them, and then taxes the remainder, when, as, and if he gets it, at personal income-tax rates up to 91.8 percent. This is what we do to encourage new production.

In my *Newsweek* article of Oct. 22 I referred, in connection with Britain, to the conclusion of Colin Clark, the Australian statistician, that the safe limit of total taxation in any country was 25 percent of the

national income, and that any attempt to take more than this is so discouraging to hard work, risk-taking and production that it must lead to inflation. Let us apply this to the United States.

It is expected that the national income for the current fiscal year ending June 30, 1952, will reach \$289,000,000,000. Federal tax receipts are now estimated at about \$63,700,000,000, and state and local taxes at about \$19,000,000,000. This would represent a total tax burden of about 30 percent of the national income. And it would still leave an inflationary deficit estimated at more than \$6,000,000,000. If we tried to cover projected fiscal 1953 expenditures of \$85,000,000,000 to \$90,000,000,000 completely by taxation, we would reach a total tax burden of 40 percent of the national income, which would parallel the plight of Great Britain.

There is only one real fiscal solution. It is a drastic slash in government expenditures. This solution is usually dismissed by Administration spokesmen as "economizing with a meat ax." But as long as the Administration continues to spend with a steam shovel it is hopeless for Congress to try to economize with a teaspoon. It is wrong, of course, to economize blindly. But it will be disastrous to continue to spend blindly.

The political problem is how to restore Congress and the Administration to a sense of their fiscal responsibilities. While the solution lies mainly in a change in present ideology, it is unlikely to be achieved without reform of our entire budgetary procedure. ❁

## How to Denationalize

November 12, 1951

Now that British socialism has been repudiated at the polls, the world waits to see how far the Conservatives will dare to go in denationalizing and desocializing. They are pledged to "stop all further nationalization," and specifically to denationalize steel. But apart from this, the outlook is not clear. They have been silent on some nationalized industries and worse than silent on coal. They have given explicit assurance that "coal will remain nationalized."

A few weeks before the election, at the Reform Club in London, I raised this problem with a group of outstanding economists and financial journalists. Though everyone in the group was anti-socialist, and expected the Conservatives to win, most of them treated denationalization as if it were difficult and all but impossible. Yet from a purely technical standpoint it is infinitely

easier to denationalize than to nationalize. The economic problems involved are minor; it is the ideological and political problems that are appalling.

This becomes clear as soon as we candidly examine the obstacles to denationalization. Let's begin with the cliché that once you scramble eggs you can't unscramble them. This might be true if you were trying to get each yolk back into its original shell—in other words, if you were trying to reestablish all the original private companies in their original form. But such an exact restoration is pointless and unnecessary. In coal, for example, the more than 1,400 collieries that the British Government took over are now divided into only nine administrative regions. These nine regions could be simply transformed into nine separate private companies. Or, if so few companies were thought to endanger competition, the National Coal Board could subdivide the present regions into whatever number or whatever size of private companies promised to combine optimum competition with optimum efficiency. Then the individual units could be put up for sale.

Such a sale would present no more inherent difficulties than are presented every day by private sales. The government could consult investment bankers as to the best financial setup and the best realizable price for each company, share or bond. Or, without attempting to set a price in advance, the government could open the various stock and bond issues to competitive bidding by investment firms or individuals. States and municipalities constantly offer their own obligations in this way. Nor would the government necessarily have to sell all securities of a desocialized industry at once; it could do so over an extended period. And it could of course retain existing governmental managers until the new owners had had time to reelect or replace them.

A well-advised government would, in offering shares, give priority to the workers in a denationalized industry, allowing them not only to purchase on installment but at a price somewhat below the market.

Some of the misgivings of the Conservatives regarding denationalization have a real enough basis. One is that if any attempt were made to denationalize coal, for example, the mine unions would immediately go on strike. Another is that nobody would buy the British railways today, which are losing money under government management, unless they had assurance that they could alter present costs and rate-and-fare levels. A third is that private investors would not buy back into these industries as long as they had reason to fear (as they now have) that the Laborites, once back in power, would reexpropriate the steel mills, coal mines, or whatnot without any compensation at all.



But none of these fears shows that denationalization is undesirable or inherently difficult. What they do show is how formidable the obstacles to it can be as long as a powerful minority, which could become a majority again, retains the socialist ideology. It is not some mystically inevitable socialist wave of the future that we have to fear, but men's ideas and intentions in the present. It is the winds of doctrine that blow today that determine the waves of tomorrow. ⚙

## Who Is Mislabeling What?

November 19, 1951

In her column in *The World-Telegram* of Nov. 1, under the heading "Misleading Facts," Eleanor Roosevelt quoted from a pamphlet published by the Foundation for Economic Education (of which the present writer happens to be a trustee). The quotation was: "The welfare state is a name that has been substituted as a more acceptable one for Communism-Socialism wherever, as in the United States, these names are in general disrepute."

"It seems to me that much that appears in this pamphlet," says Mrs. Roosevelt, "is dishonest in its thinking. In the first place, the mere tying together of Communism and Socialism is dishonest. They are two quite different things. . . . We can have opinions as to whether all the things that have been done . . . under the name of 'welfare state' are wise. . . . However, that does not make us Communist or Socialist."

Mrs. Roosevelt frequently affects to deplore the "smear" technique. Yet she begins her criticism of a statement with which she disagrees by calling it dishonest. This is an *argumentum ad hominem*—an attack, not on the merits of an idea, but on the character and motives of those who advance it. Such an attack not only lowers the level of debate, but is irrelevant to the real question, which is whether or not the idea is true.

If there is any charge of dishonesty or deliberate mislabeling to be brought, indeed, it might much more justifiably be lodged against those who deny any connection between the welfare state and Socialism, or between Socialism and Communism. But I prefer to believe that this denial stems in most cases from mere lack of knowledge and confusion of thought.

The *Wohlfahrtsstaat* concept had its origin in Germany, shortly after Bismarck, in 1881, introduced his first social-security bill for "the welfare of all." If we leap to Feb. 19, 1949, we find Supreme Court Justice William O. Douglas, in a speech at Occidental College, lumping "laissez-faire economics" with "Communism

and Fascism" and hailing "the human welfare state" as "the great political invention of the twentieth century."

Then on March 20, 1949, in *The New York Times Sunday Magazine*, Barbara Ward developed the thesis that "In the last four years, the most important single feature on the British scene has been the creation not of the Socialist state but of the welfare state." "So far," she argued, "nationalization has touched only a tiny fragment of the economy." Tiny, indeed. All that had been nationalized was coal, the railroads, civil aviation, telephone, telegraph, gas and electricity service, the Bank of England, and new housing! To contend that nationalization is unimportant in England because it exists only in the key industries is like arguing that Stalin is unimportant in Russia because he constitutes so small a percentage of the total population.

The "welfare state," in short, has come to mean in practice the Socialist state plus the handout state plus the controllist state.

I must go on to point out, finally, that Socialism and Communism are fundamentally the same. Karl Marx, the fountainhead, used the terms interchangeably. The Russian Communists constantly boast of the achievement of their "Socialism." They call their country, in fact, the U.S.S.R.—the Union of Soviet *Socialist* Republics.

Russia is the ghastly symbol of what happens to human liberty when Socialism becomes complete, instead of merely partial as in England, France, or Sweden. The results shock naïve "democratic" Socialists and ex-Communists like Arthur Koestler, who deny that the Russian brand is Socialism at all. They call it "state capitalism," forgetting that, by their own definitions, this is a contradiction in terms, like speaking of a triangular circle. "Capitalism" means *private* ownership of the means of production, and Socialism means government ownership of the means of production. What has taken place in Russia, China, and Yugoslavia is not some hideous betrayal of Socialism, but its consummation and inevitable end product. ⚙

## How to Depoliticalize Money

November 26, 1951

Two years ago a Congressional subcommittee headed by Sen. Paul H. Douglas made a careful study of monetary policy. It emerged with the conclusion that "the freedom of the Federal Reserve to restrict credit and raise interest rates for general stabilization purposes should be restored." But tucked away in a footnote was a dissent from Congressman Wright Patman: "Steps



should be taken," he said, "to *increase* the responsibility [i.e., the subservience] of the Federal Reserve System to the executive department."

Now, by one of those political miracles that happen so often in the Administration's favor, a new subcommittee has been appointed, headed by none other than Patman himself, to investigate the same subject all over again.

There is the usual affectation of open-mindedness; but no one can be in any real doubt concerning the conclusions at which Congressman Patman is determined to arrive. He has already sent out heavily loaded questionnaires.

Patman, in fact, as the November monthly letter of the National City Bank of New York reminds us, has a long record in support of the crudest and most flagrant inflation. It was "a shame and a disgrace," he said on the floor of the House on June 27, that the Federal Reserve had allowed government bonds to decline below par. He wanted Congress to *compel* the Federal Reserve Banks to buy at par or better any government security issued at par. In 1932–35 we find him advocating Treasury issues of paper money to pay off "adjusted service certificates" held by first-world-war veterans. In 1941 he proposed in a radio speech that the government buy the stock of the Federal Reserve Banks: "Then it will not be necessary for the government to issue and sell interest-bearing bonds. Then as money is needed, non-interest-bearing bonds can be delivered to these twelve banks, credit given for them on the books of the banks, and checks drawn by the Treasury to pay any debt that is owed by the government." In other words, the government can just print all the money it needs as it goes along.

The Patman proposals are a threat of hyperinflation. What is desperately necessary today is the exact opposite of the course he proposes. The Federal Reserve System must be taken out of politics. It must be freed from domination by the President. It is still under that domination. Between June 21, 1950, a few days before the outbreak of war in Korea, and Nov. 14 of this year, the Federal Reserve Banks on net balance had bought nearly \$6,000,000,000 of additional government securities, putting out more money and feeding inflation.

The hard fact is that the central bank in practically every nation today has been or is being used as an enormous inflation factory to serve the incumbent government's political purposes. In view of this hard fact, I should like to advance a counterproposal of my own. Let the Federal Reserve Board retain every power it already has to prevent or to halt inflation. Give it,

if necessary, added powers of disinflation. But remove entirely from the board any power to inflate or "reflate."

This would mean that neither the Federal Reserve Board nor the Federal Open Market Committee would any longer be permitted to lower reserve requirements on its own initiative, to compel open-market purchases of government securities, or to lower rediscount rates. (And that would prevent any repetition, for example, of the disgrace of 1927, when the Federal Reserve Board not only ordered the individual Federal Reserve Banks to lower their rediscount rates, but openly overrode the Chicago bank when it refused.)

Under this proposal, on the other hand, full responsibility would still rest on the board for any further inflation. For it would still have full powers to *increase* reserve ratios, to recommend *sales* of securities, and to order a *higher* discount rate by Federal Reserve Banks when it thought such actions necessary. Any "reflationary" initiative could come solely from the individual reserve banks. ☸

## Day of Disillusion

December 3, 1951

For the last two or three years we have been repeatedly told about the "miracle of recovery" brought by the Marshall Plan in Europe. And suddenly another European crisis is upon us; suddenly the British can't solve their balance-of-payments problem; suddenly the French economy is in another tailspin; suddenly everybody complains about a "dollar shortage" again. And suddenly, once more, it is all our fault.

It seems that, as Europe reminds us, we just can't do anything right. Not only do we give them too little money, but we give it for all the wrong things. We give it for armament, whereas the real need is for Europeans to live more comfortably. Thus The London *Economist* says bluntly that "rearmament is a serious threat to the internal stability of Europe" and: "It may prove healthier for Europe to receive more dollars to keep its civilian economies steady and fewer to defend its frontiers."

The French are sure of it. In a dispatch from Paris to *The New York Times* of Nov. 10, Harold Callender wrote: "High officials here contend that while the aggregate of United States aid may be sufficient, too much has been earmarked for military use and not enough for civilian economies. 'Europe is not ready for all the military equipment that is provided, but desperately needs dollars to buy raw materials to keep its industries going,'

said one expert. Moreover,” Callender continued, “the French are annoyed by the slow receipt of [U.S.] aid.”

The situation has reached a point where even American taxpayers are beginning to ask questions. Here is an excerpt from a letter I have just received from one of them in Switzerland: “As I travel through Europe my admiration for the patience of the American taxpayer grows in the same measure as my disgust at the inefficiency and nonchalance of the Europeans. As I look around me all over Western Europe at the business-and-pleasure-as-usual attitude, the crammed theaters and movies, football matches, horse racing, automobile racing, and stores full of everything to buy, I know that nobody ever gives credit to the long-suffering American taxpayer, who has made all this possible through the billions given to foreign countries.”

Why has postwar recovery in Europe proved so transitory and insecure, so vulnerable to recurrent crises? Clearly because it has never rested on a sound basis.

The rate of recovery in Europe after 1947 was no more than what might have been expected in any case, if we judge by the standard of previous postwar recoveries. And the Marshall Plan got far more credit even for this result than it earned. Macaulay in his *History of England*, reminded his readers that “No ordinary misfortune, no ordinary misgovernment, will do so much to make a nation wretched as the constant progress of physical knowledge and the constant effort of every man to better himself will do to make a nation prosperous.” EGA got credit that belonged to what Macaulay called “the exertions of private citizens.”

In fact, it is an open question, when we consider the present French and British crises, whether Europe would not be better off today if we had never given it a dollar of Marshall aid. For then it might have been forced to take the hard course that alone would have brought a durable recovery.

Contrary to the outcries from European officials, the present crises in Europe are not the result of our failure to provide enough dollars, or the result of their own tremendous armament effort. They are the results of their own spending, inflationist, controllist, and socialist policies. In my 1947 book, *Will Dollars Save the World*, I pointed out that “The report of the sixteen [European] nations shows that they have no intention of abandoning the major policies which have brought them to their present crisis. They will continue as before to impose price control and exchange control, food subsidies, cheap money, ambitious capital investment programs, government-dictated production, nationalization, and socialism.” Well, they are still at it. ❁

## ‘Arms’ or ‘Economic’ Aid

December 10, 1951

The central fact about our so-called “arms aid” to Europe is that it is only another name for general economic aid.

When the United States Government gives \$5,000,000,000 for defense to European governments, either in the form of cash or military end items, then—unless Europe’s total armament budget shows a net increase of at least \$5,000,000,000 over what it would have been if we had made no contribution—we have simply released Europe’s own funds for *other* governmental expenditures (such as social security, food subsidies, deficits on nationalized industries), or we have allowed European governments to reduce taxes by that much.

The only way we could make sure that none of our funds intended for European rearmament were being in effect diverted to other purposes would be to insist on a minimum defense expenditure by each government and a ceiling on all its other expenditure. Even this would not be enough; we should have to assume detailed supervision. *The New York Times* reported on Nov. 28, for example, that our officials are finding “an immense amount of waste in European defense expenditures—installations designed to prevent a German invasion of France that make no sense in terms of present-day problems, unneeded Navy outlays, expenditures on obsolete arms and services,” etc.

But no responsible person would dream of recommending that our officials should dictate European budgets. We still face the dilemma to which I devoted an article in *Newsweek* of Nov. 3, 1947; If we give aid without imposing conditions, it will be dissipated without bringing the results we seek; if we try to impose the necessary conditions, the attempt must bring immediate resentment and ill will.

The argument is frequently put forward that the reason we need to give military aid to Europe is that Europe cannot make the items it requires. This argument is empty. Europe could simply *buy* the goods from us, as we buy the rubber, tin, and wool we do not ourselves produce. The argument for our military-aid program is basically economic—that Europe just can’t afford to pay for its own rearmament. Let’s see. As no figures are available of our proposed military aid to individual countries, we are compelled to deal with overall figures. The overall “gross national product” of Belgium, Luxembourg, Denmark, France, Iceland, Italy, the Netherlands, Norway, Greece, Turkey, and the United Kingdom is estimated at \$128,000,000,000.

Total governmental expenditures of these countries this fiscal year will come to about \$30,000,000,000. Of this, \$8,600,000,000 will be for defense. In other words, these countries are spending on defense less than 30 percent of their total governmental expenditures and only about 7 percent of their national incomes.

On what assumption, then, are we contributing \$5,200,000,000 in arms aid? On the assumption that these countries can neither (1) increase their expenditures on defense to 11 percent of their gross national product; nor (2) reduce their nondefense governmental expenditures from \$21,400,000,000 to \$16,200,000,000 and use the saving for defense; nor (3) increase their national product by 4 percent.

The American public has never been given the factual basis, if any, that supports this remarkable conclusion. The Congress that voted the money wasn't even curious enough to ask for the factual basis. The Senate Appropriations Committee, before voting for the \$7,300,000,000 overall foreign aid program, held hearings for just *one day*! Who cares for \$7,300,000,000? After all, it is only equal to our total Federal expenditures for all purposes in the fiscal year 1938 and to the estimated 1952 deficit.

For purposes of comparison with the European rearmament effort, the United States is spending this year (not even counting the military aid to foreign countries) \$47,000,000,000 on defense, which is 14 percent of our gross national product and 68 percent of our total government expenditures. ❀

## Guns, Butter, and Disruption

December 17, 1951

"We didn't have the courage to put guns ahead of butter; to put security ahead of selfishness; to put the cause of liberty ahead of luxury." This was the verdict reached by the Senate Preparedness subcommittee headed by Lyndon Johnson.

The evidence does not support this sweeping indictment of the American people. It is true that our defense program has gravely lagged. But the basic cause has not been public apathy. Some of the real causes were cited by the Johnson committee report itself, summarized by *Newsweek* in the Dec. 3 issue. Others can be found in the *Newsweek* report of Dec. 10 on the lag specifically in warplane production. If these detailed reasons could be reduced to a single reason it would come down to this: that while Russia since the second world war has continued without intermission to produce for another war, the U.S., in spite of the very heavy governmental

expenditures for "defense" even prior to June 25, 1950, suspended major production of weapons and scrapped, converted or mothballed its war facilities.

Since the outbreak of the Korean war the Defense Department has been faced with this problem: Should it resume mass production of weapons now obsolete? Should it order mass production of present guns, tanks, and planes known to be inferior to corresponding Russian matériel? Or should it keep working indefinitely at blueprints and pilot models? Clearly some working compromise must be adopted. It is not uncommon to hear of the Defense Department submitting more than a thousand changes in design or specifications on a single item over the course of the last year. Most of these changes may be unimportant, but some may involve costly delays. Deliveries of definite quantities of an item on definite dates are possible only when a design has been frozen and a clear go-ahead signal given. There is little evidence that the defense production program has been set back in any substantial way because civilian production has been needlessly big. It is easy enough for any official with a taste for coercion and histrionics to order a cut in the allocation of steel or copper or even an entire death sentence for whole industries. But it does not follow that this will speed up defense production; it may do the exact opposite.

And the real need is Production, not Austerity or Sacrifice for its own sake. There are always those, of course, who love to wear loud-colored hair shirts in public. When President Roosevelt declared in May 1940 that there was no reason for the country to become "discomboomerated" by the defense program, the remark met a storm of criticism. But he would have been quite justified if he had said merely that no one should be *needlessly* discomboomerated. Needless discomboomeration means needless disruption. Yet the hair-shirt wavers demand this purely ritualistic sacrifice. Their main emphasis is not on more guns but on less butter.

The real danger is that our defense program will be snarled up not by too little government interference but by too much. The insistence on price controls is a case in point. Price controls combined with allocations have so greatly distorted the supply-and-demand picture that no one can be sure whether or not we are heading for actual overproduction of steel. Eugene G. Grace, chairman of the Bethlehem Steel Corp., says we are. Government controllers are inclined to scoff at this. But the demand for steel today is not determined by free prices in free markets. As *The Wall Street Journal* illustrates it, a man who wants 10,000 tons of steel may get ration "tickets" for only 1,000, while a man who can



use only 1,000 may manage to get “tickets” for 1,500, and may take that much as insurance.

Manufacturers with whom I have talked think we would be much farther ahead if firms with war contracts got priority tickets for the metals they needed and all other “allocations” were left to the traditional method of a free economy—the play of supply and demand and free prices. ❁

## A Budget Out of Control

December 24, 1951

In a few weeks President Truman will present Congress with the budget for the next fiscal year. If either precedents or predictions are any guide, the spending he will recommend will be staggering—somewhere around \$85,000,000,000, or more than even Franklin Roosevelt succeeded in spending in the whole nine years from 1933 through 1941. But Mr. Truman will blandly announce that his budget has been cut to the bone—that any attempt to reduce it will bring on a third world war or military defeat. He will defy critics of his budget to make a single reduction. His Congressional opponents will, of course, eloquently denounce his “reckless spending.” A corporal’s guard, under the leadership of Senator Byrd, will unsuccessfully propose cuts. The appropriations will end up by being substantially what the President asks for. In fact, it will be unprecedented if Congress doesn’t make a few appropriations and handouts over even Mr. Truman’s veto.

This is the outlook we face. It is a budget out of control.

And none of the proposals that are being seriously considered to give us a responsible budget goes nearly far enough to achieve one.

We will not have a responsible budget in this country, in fact, until Congress has been deprived of the power to make any appropriation not recommended by the President. This is the wholesome rule that has long prevailed in Britain. No expenditure can be proposed in Parliament except by “the government.”

It is still not generally understood that the legislature’s only justified “power of the purse” is the power to *withhold* the people’s purse from the executive—not the power to put its own hands in that purse. If the watchmen of the Treasury are allowed to put their own hands in the Treasury, they cease to perform their function as watchmen. A congressman cannot be depended on to serve the taxpayers if he must also serve the pressure groups. Congress should have the power to reduce

proposed Federal expenditures, but never the power to initiate or increase them.

Such a change in the powers of Congress would raise the whole level and tone of our political life. As Henry Jones Ford pointed out in his *Representative Government* in 1924, to disable members from introducing measures proposing any added appropriations or salaried offices would “of itself shut out most of the bills congesting American legislative calendars.”

It would do far more. It would eliminate the type of congressman who holds office mainly by promising or giving handouts of the nation’s money to pressure groups in his own district. We will never have a responsible budget as long as the President, the House, and the Senate are all encouraged or even permitted to compete with and outbid each other in spending schemes.

Other procedural reforms are needed and, fortunately, could more easily become realities. For several years there has been a lively debate between those who favor a single overall annual appropriation by Congress or, as now, a series of separate appropriation bills for special purposes. To achieve economy the best solution would be to have both. Each fiscal year Congress should authorize a total *maximum* overall expenditure not to be exceeded. But it should continue to require the President to get a separate authorization for each special purpose. The President should not be allowed to spend the whole of these separate authorizations if they exceed the total overall maximum that Congress has previously fixed. He would have to make his own specific cuts (but be permitted no specific increases) to bring the sum of the special authorizations within the authorized overall total. In other words, the President could spend only whichever sum was lower.

A third reform would be more full-time research assistants for the major Congressional committees—to try to keep the Army, for example, from again ordering enough front-axle-housing gaskets to last for 104 years. ❁

## Canada Breaks the Ice Jam

December 31, 1951

From Sept. 19, 1949, to Sept. 30, 1950, the Canadian dollar, under exchange control, was pegged at 90 American cents. Then the peg was pulled and the rate was left to the mercies of supply and demand. Instead of falling, it went up. It remained around 95 cents, with small fluctuations on either side, until a few weeks ago, when it rose above 97 cents.



On Dec. 14 Canada abolished exchange control entirely. This means that, for the first time in twelve years, Canadians will be able to spend their money for whatever they please, wherever they please. They will again be able, for instance, to buy American securities on the New York Stock Exchange or deal in wheat futures in Chicago. And Americans with investments "frozen" in Canada can now, if they wish, get them out.

Canada thereby becomes the first major country to abolish exchange control. The United States and Switzerland were the only countries that never directly imposed it. Peru, in 1949, set its own currency rate free, but its example attracted little attention. Canada's step, however, may prove the first real break in the world ice jam of exchange controls. Even Britain seems to have been influenced by it, and has permitted the resumption, within very narrow price limits, of private exchange transactions.

Both the theory and practice of exchange control, in other words, are beginning to fall apart. In *Newsweek* of Sept. 8, 1947, I wrote: "Nearly every currency in the world . . . is overvalued in terms of the [American] dollar. It is precisely this overvaluation which brings about the so-called dollar scarcity." But this glaring fact was ignored or denied not only by European but by American bureaucrats, who poured billions of our dollars into Europe to finance its self-created trade deficits.

Then on Sept. 18, 1949, Sir Stafford Cripps completely reversed all his previous pledges and arguments and slashed the pegged rate of the pound from \$4.03 to \$2.80. Two dozen other nations took similar action within a week. This temporarily improved the balance of world trade; but it was still not the right step. "What was called for," as I pointed out in *Newsweek* (Oct. 3 and 31, 1949, and Jan. 9, 1950), "was not continued

exchange control with lower fiat rates, but the restoration of free exchanges."

This is the step that Canada has at last taken. It is the most hopeful international development in many months. The chief remaining obstacle to a world restoration of freedom and sound money is the International Monetary Fund, an unnecessary institution set up, under the influence of the late Lord Keynes and Harry Dexter White, on a completely unsound basis. The minimum reform on which the managers of the Fund should now insist is to strike out Sections 3 and 4 of Article IV of the Articles of Agreement, which prohibit exchange transactions within any country that vary by more than 1 percent from the official parity. This in effect forces the continued imposition of exchange control.

The adherents of exchange control have devised derogatory names for freedom. They call free-market rates "floating" rates, "drifting" rates. What they overlook is that exchange control under fixed police rates merely conceals instability without curing it. It is precisely because free rates do honestly reflect and reveal instability that they force officials to take the steps necessary to restore confidence. And it is precisely this that Finance Minister Abbott of Canada has discovered: "The conclusion I have come to is that we would be better advised not to rely on exchange restrictions but rather on the general handling of our domestic economic situation to keep us in reasonable balance with the outside world." And the Canadian dollar is strong because he has acted in accordance with this conclusion. For the first seven months of the fiscal year which began April 1, for example, Canada had a budget surplus of \$604,700,000. There has been a steadily increasing flow of foreign investment into the country. ❁

1952



## The Limits of Taxation

January 7, 1952

How much taxation can our economy stand? This question will become more insistent than ever when Mr. Truman presents his new budget.

One of the latest efforts to answer it appears in a pamphlet published by the United States Chamber of Commerce under the title: "How Much Can Our Economy Stand?" The pamphlet calls attention to some startling facts.

For the three fiscal years, 1952 through 1954, government expenditures will take on the average approximately *one-third* of each dollar of the income of every person in the country.

Though Mr. Truman, in his budget message last year, stated that the government "must practice rigid economy in its nondefense activities," he went on to advocate nondefense expenditures higher than in any previous year in our history and nearly double those of the fiscal year 1948.

To analyze a \$57,000,000,000 military appropriation, the Senate Appropriations Committee had the assistance of only one technical staff member.

Personal income taxes now range from 22.4 percent on the lowest bracket to 92 percent on the highest.

According to Secretary Snyder's estimates, there is \$68,000,000,000 of personal income available for additional taxation; but more than 73 percent of this amount falls in the income tax bracket of less than \$2,000.

If the government seized all personal income above \$6,000 it could not get more than \$6,500,000,000 additional revenue. This would fall nearly \$1,000,000,000 short of this year's foreign-aid program alone.

The corporation income-tax rate, which never exceeded 40 percent during the second world war, was raised by the 1951 Tax Act to 52 percent. In addition, an excess-profits tax takes 82 percent of corporation earnings in excess of 83 percent of the average of the best three years from 1946 through 1949. Federal taxes can run as high as 70 percent of a corporation's total earnings.

The Canadian Minister of Finance, D.C. Abbott, said in April 1951: "I am not happy about corporation tax rates when they go over 50 percent. . . . It would be only too easy to take a superficially popular line and increase these taxes to a point which while yielding larger immediate revenues would do great damage in the longer run to the economy as a whole."

Heavy progressive taxation in the United States is retarding capital formation and the growth of production. Until the past decade our productivity per

man-hour increased about 2.5 percent per year. Since 1940, however, the rise in productivity has been below the long-term trend.

The Chamber's pamphlet concludes that our present tax programs penalize saving and risk-taking and destroy the incentives to work. This conclusion carries additional force if taken in connection with a study made by the Australian economist Colin Clark in the (London) *Economic Journal* of December 1945. There, as the result of a survey of a large number of countries which he summarized in impressive tables, Clark concluded that "the critical limit of taxation is about 25 percent of the national income, or possibly rather less." That conclusion was based, as he has since written, "not upon theoretical considerations but upon a study of the actual experience of attempts which had been made, at various times and places, to exceed this limit."

A 25 percent limit is, of course, purely empiric, not "scientific." The factors involved are so complex, indeed, that the precise limit to taxation under all conditions is probably indeterminable. Yet Clark's statistics do, as he declares, "appear to give very considerable support to the hypothesis that once taxation has exceeded 25 percent of the national income (20 percent or less in certain countries), influential sections of the community become willing to support a depreciation of the value of money," the political forces making for inflation become irresistible, and production is seriously undermined.

We urgently need further statistical studies of the limits of taxation. ⚙

## More about Arms Aid

January 14, 1952

As I have pointed out in this column before, the distinction between "economic" aid and "arms" aid to Europe is in practice very questionable. Any money or material we give to a European government for any purpose, however specifically earmarked, can simply release that much of its own funds for other purposes. The only way we could make sure that no such diversion of resources was taking place would be to dictate and supervise every item of that government's budget—which no one dares to propose.

Here are this fiscal year's armament expenditures of our aid beneficiaries stated as a percentage of (1) their gross national product, and (2) their total governmental expenditures. Our own record is compared.



### Defense Expenditures

Country	% of G.N.P.	% of T.G.E.
Belgium-Luxembourg	5.3	20.7
Denmark	2.7	18.0
France	9.3	32.2
Italy	5.0	26.7
Netherlands	7.0	24.0
Norway	5.0	22.2
United Kingdom	9.6	29.5
Greece	8.3	27.5
Turkey	5.4	25.2
United States	14.0	68.0

The United States, in short, is spending on armament not only more than five times as much *absolutely* as these other nine nations combined (\$47,000,000,000 against a total of \$8,600,000,000); but it is spending for more *relatively*—14 percent of its gross national product compared with an average of less than 7 percent for the nine beneficiaries.

Now many Europeans contend that this is just as it should be. They would impose a sort of international progressive income tax. Prof. James Meade of the London School of Economics advocated this explicitly in the October 1951 issue of *Lloyds Bank Review*: "The United States, with its higher real income per head, should contribute a higher proportion of its national income to the common defense. Indeed, it is inevitable that the progressive principle should be adopted.

Baldly stated, this is the view that the man or country that works more, saves more, and produces more somehow owes part, if not half, of the difference to the man or country that works less, saves less, and produces less. *The London Times* has carried the "progressive principle" to even greater lengths. "If it is true, as; seems likely," it wrote on Dec. 19, "that Britain's [armament] effort is the maximum that is possible economically, and the United States effort is the maximum that is possible politically—for there can hardly be any economic limits to her capabilities. . . ." In other words, no burden can possibly be too big to lay on our taxpayers.

But the second percentage column of the foregoing table is even more significant than the first. The United States is devoting 68 percent of its total Federal expenditures to armament. (Or 75 percent, if our foreign arms-aid program is included.) This means that only 25 to 32 percent of our total government outlay goes for nondefense items. But the arms-beneficiary

countries are spending an average of only 25 percent of their total budgets on defense, which means that they are spending 75 percent on nondefense items. They are robbing their own national defense at the cost of comparative luxuries. It is their nondefense expenditures that are responsible for three-fourths of their economic strains and inflation.

Why must American taxpayers pay \$5,200,000,000 for Europe's defense? Why cannot the Europe's arms-beneficiary governments reduce their nondefense expenditures from \$21,400,000,000 to \$16,200,000,000, and themselves add the difference to the modest \$8,600,000,000 they are spending for defense? Why, because European politicians prefer to spend money on deficits for nationalized industries, food subsidies, socialized medicine, pensions, and other handouts calculated to snare votes at home, should the American taxpayer be called upon to dig in his pocket for what these politicians refuse to pay for their own nations' defense? ❁

## A Ceiling on Spending

January 21, 1952

The most promising approach in a long time to the Federal budget problem is the resolution introduced by Rep. Frederic R. Coudert, Jr., Republican of New York, to limit total expenditures in the coming fiscal year to revenues from present taxes.

If this resolution were passed and adhered to, it would end deficit spending and the inflation that flows from it. It would put a maximum ceiling on overall expenditure for the 1953 fiscal year of, say, the \$70,000,000,000 now estimated as the probable tax receipts under existing tax laws; and if the President asked for a total of \$85,000,000,000, Congress would send his budget back and require him to submit a new one with \$15,000,000,000 slashed from it.

This should not be treated as a partisan proposal. It has already had the endorsement of Lewis W. Douglas, onetime Director of the Budget under Franklin D. Roosevelt and our former Ambassador to Great Britain. It is an essential first step if Congress is to reclaim the reality of its power of the purse under the Constitution.

But passage of the Coudert resolution, or one essentially like it, would be a first step only. To make it most effective it would need to be supplemented along the lines indicated in this column (*Newsweek*, Dec. 24, 1951). Not only should Congress limit the President each year to a total overall maximum expenditure, but it should continue, as in the past, to require him to get

separate authorization for each special purpose. And the President should not be allowed to spend the whole of these separate authorizations if their total exceeded the overall maximum Congress had previously fixed. He would have to make his own specific cuts (but be permitted no specific increases) to bring the sum of the special authorizations within the authorized overall total. In other words, he could spend only whichever sum was lower.

This double limit would permit Congress to say in effect: "If we are to avert further inflation our government, like everyone else, must live within its income, X billions of dollars is the largest tax burden that can safely be laid on the American economy at this time without destroying incentives and disrupting production. Our government must keep its total expenditures within that sum. We in Congress are seldom in a position to know precisely what specific sum is necessary for each specific purpose or what precise amount can safely be cut from each specific request. We are therefore often compelled to give the President the benefit of the doubt on specific authorizations. But we do know that the American economy cannot stand more than the overall ceiling we have fixed. It is up to the President to make his own detailed cuts; but he must cut his suits to fit his available cloth."

Congress could not use this plan to evade its own clear budget responsibilities. If it first fixed an overall expenditure ceiling of, say, \$70,000,000,000, and then went on to authorize a series of special appropriations totaling \$80,000,000,000, including pet projects of its own not asked for by the President, it could not reasonably complain if the revised budget presented by the President cut out all the projects or increases added by Congress or (what might be even more serious) included all the authorized pork-barrel or inessential expenditures but applied the whole required cut to some essential activity with the straight-faced argument that the overall total permitted by Congress did not allow enough funds for it.

The double-limit plan, in short, though it would put more specific responsibility on the President, would fail if Congress tried to use it to evade its own legitimate responsibilities.

But what is immediately essential, regardless of the procedure used, is that total expenditures for the new fiscal year be kept at least within the revenues that would be raised by existing taxes. The only alternative is a further wave of inflation whose fateful consequences cannot be foretold. By every calculation of possible yields from still higher income-tax rates, by every test

of a tolerable burden, the tax ceiling has already been reached. ❁

## One Message Too Many

January 28, 1952

At this time of year the conscientious congressman or editor, or for that matter any conscientious citizen anxious to "keep abreast of things," has an enormous amount of homework to do. The President dumps in his lap three messages—on the State of the Union, on the Budget, and on the Economic Report. The first anyone can usually assimilate; it is comparatively short, and read by the President in person. The budget message is a necessary evil. But at least we could be spared the economic report. Its information is secondhand. Its chief recommendations are and ought to be found in the other two messages. And the rest consists mainly of giving "scientific" and "economic" reasons for what the President has done or wants to do for political reasons.

The economic report, in brief, is Administration propaganda paid for by the taxpayers, and it promulgates more fallacies than the rest of us have time to answer. The latest opens with the declaration that; "The past year has been marked by great gains in our basic economic strength." The unwary reader might be led to suppose from this that the ideal way to increase our economic welfare is to have an immense diversion of men and resources to war and armament.

On the next page we learn that "Our total [1947] output, measured in 1951 prices, was more than \$90,000,000,000 higher than in 1939." Our curiosity piqued by this, we turn to tables in the rear, and find that our 1939 total output, measured in 1939 prices, was \$91,000,000,000. But measured in 1951 prices it was \$179,000,000,000. So we have increased the total output even of 1939 by \$88,000,000,000, simply by changing the measuring rod! We can get our national income up to any figure merely by depreciating the dollar.

We are not surprised to learn a little later that "true economy" is something vastly different from economy. True economy means "the making of necessary outlays," and all of Mr. Truman's proposed \$85,000,000,000 of outlays are of course necessary. And anyway, it is better "to run a deficit of limited size and duration in the Federal budget" than "to run a deficit in our national security effort." And much more semantics of the same kind.

The truth is that all three messages are profoundly disheartening. They contain no acknowledgment anywhere that inflation is caused by the government's own

policies of reckless spending, deficit financing, low interest rates, using the Federal Reserve Banks as a dumping ground for government securities—in short, of increasing the supply of money and credit. Instead, on top of unparalleled armament and civilian spending, Mr. Truman can think only of still more spending—subsidized housing, socialized medicine, Federal aid to education, bigger social-security payments, bigger “public assistance,” bigger veterans benefits, the St. Lawrence Seaway and power project, bigger farm price supports, bigger handouts to Europe, bigger handouts to the “underdeveloped” countries.

And after asking for all these expenditures that increase inflation, he promises to “control” and “contain” inflation by the fraudulent, dangerous, and disruptive device of price control. He asks, in addition, for still more strait-jacket controls over the economy. Not once does he promise to *halt* inflation—by simply ceasing to create more money and credit.

Not only does Mr. Truman show no understanding of inflation. He shows no understanding of how and why wealth is created. His cure for the bottomless poverty of Asia, like his cure for everything else, is more handouts from the U.S. Treasury. This, he tells us, will avert “stomach Communism.” The phrase is revealing. It implies that Communism is a cure for empty stomachs rather than a cause of them. The real cure for empty stomachs is capitalism. It is economic freedom that brings maximum production of food and clothing and housing. And not until the “underdeveloped” nations understand and adopt a free market economy will they emerge from their misery. ☸

## ‘Where Would You Cut?’

February 4, 1952

For the last eighteen years, whenever a congressman or a mere taxpayer has ventured to express concern about the ever-mounting total of Federal spending, he has been promptly squelched by some Administration spokesman with the rhetorical question: “Where would you cut?”

The question is seldom asked as a sincere quest for information. It is a taunt, uttered in the assurance that there are certain politically sacrosanct causes, and that none will dare question the amount of any expenditure made in the name of such causes. The sacred word in Washington today is “defense.” In our cities it is “education.” In England it is “full employment.” Any private business that tried to run its budget on this incantation

basis would soon be on the rocks. And so, eventually, will a government.

The basic fallacy involved in the question “Where would you cut?” is that it assumes the burden of proof to be on those who wish to make economies. But the real burden of proof obviously belongs on the executive who proposes the spending. It is his job to make a positive case for every dollar of that proposed spending. And in the whole fantastic new budget of \$85,400,000,000 there are very few places where this positive case has been seriously made. Mr. Truman’s defenders seem to think it is enough to say of any questioned item: “Secretary Brannan has asked for it,” or: “The Army has asked for it.” But no private firm could afford to assume that a mere unsupported request was a sufficient reason for increasing the spending budget of one of its departments.

Mr. Truman asks, for example, the tremendous sum of \$10,500,000,000 for “military, economic, and technical assistance” to foreign governments in the next fiscal year. He demands this huge sum on familiar rhetorical grounds: “We cannot . . . isolate ourselves from threats to other free men,” etc. But he never tells us why the amount should be \$10,500,000,000, nor why the NATO governments of Europe cannot pay more than \$8,600,000,000 this year for their own armament, though they manage to find \$21,400,000,000 for non-defense expenditures, largely socialistic. (See this column Dec. 10, 1951, and Jan. 14.)

Those who assert it is the responsibility of Congress rather than the President to bring spending down to a bearable level by cutting the budget item by item have simply never stopped to consider what this would mean. The \$85,400,000,000 for which Mr. Truman asks is the aggregate amount to be spent by 1,252 different organizational units. How can Congress determine to exactly how much, if anything, each of these 1,252 spending or getting units is entitled? Particularly when the individual budget of each one of these agencies or categories is in turn usually made up of hundreds of items?

What we do know is that wherever Congress has pried into the details of the present Administration’s spending it has almost invariably found gross waste. On Dec. 11, for example, House investigators found that the Army had ordered enough front-axle housing gaskets for jeeps to last more than 104 years, enough engine valve tappets to last for 79.4 years, enough engine clutch washers to last for 84.7 years. And so on. This is a tiny sample of the waste. It is simply impossible for Congress to go into an infinity of such grisly details.



The individual taxpayer, in brief, is seldom in a position to say precisely *where* the budget should be cut, but he can say *how* it should be cut. We will not have an orderly and responsible budget until we reform our entire budgetary procedure. (See this column Dec. 24, 1951.)

But the first and indispensable step is for Congress to adopt the Coudert resolution. It should send Mr. Truman's unbalanced and irresponsible budget back to him with the request that he submit a revised budget cutting his proposed \$85,400,000,000, of spending down at least to the \$71,000,000,000 of revenues expected under present tax laws. If the President declines this opportunity to use his own scalpel, he can hardly complain if Congress applies a meat ax. ❁

## Delusions of 'Productivity'

February 11, 1952

One of the grounds of the steel-workers' union demand for higher wages before the War Stabilization Board is "increased productivity." The new wage pattern set by the WSB decision will ostensibly apply only in steel, but precedent may impose it on all industry. The principle of "annual improvement" increases in wages therefore deserves far closer scrutiny than it has hitherto received.

1—Most of the clauses in wage contracts providing for "productivity" increases are fraudulent, because the specified annual wage increase must be granted unconditionally, *whether or not* the anticipated increase in productivity actually occurs.

2—Virtually all labor operates with tools or machines of some sort. There is no such thing as pure "labor productivity"; there is only combined labor-land-capital productivity. The production ascribable to labor cannot be physically separated from the production ascribable to machines.

3—An increase in the productivity of a particular machine, plant, company or even industry does not necessarily imply a *general* increase in productivity. Or vice versa. The Bureau of Labor Statistics has estimated that from 1939 to 1950 productivity per man-hour (which in longhand means man-machine-method-management hour) went up 23 percent in the bituminous coal industry but down nearly 13 percent in anthracite. Would John L. Lewis favor, say, raising wages 23 percent in the bituminous mines and *cutting* them 13 percent in the anthracite mines?

4—The *overall* increase in man-hour productivity is very difficult to measure. An estimate hitherto widely accepted among statisticians is that in the long-run past, productivity has risen about 2½ percent a year. But there is little evidence that this rate has held in recent years. Estimates recently released by the Manufacturing Census of 1947 show that the physical output of manufacturing was 84 percent higher in 1947 than in 1939—using 1939 "weights"—and 69 percent higher using 1947 weights. But man-hours in manufacturing increased in that same period by 68 percent. Therefore, using 1939 weights, productivity per man-hour increased only 9½ percent in those eight years, or at an annual rate of barely more than 1 percent. And if we use 1947 weights we find no increase in productivity per man-hour at all! Yet vast sums of capital were invested in that period in new tools.

5—Between 1939 and 1947 straight-time hourly earnings increased 89 percent, and gross hourly earnings 95 percent. In the same period wholesale prices of manufactured products rose 82 percent. In the absence of a real increase in physical productivity, higher hourly wages can only be paid, in the long run, out of higher prices.

6—Throughout our history, competition and the free market economy have been solving, infinitely better than any bureaucrat could, the problem of how the gains of increased productivity should be distributed. To the extent that added productivity has been brought about by an increase in the individual worker's own effort or skill, the gain has gone directly to the worker. To the extent that the gain has been brought about by more capital investment (more or better factories and machines) enough of the gain has gone to the investor to pay an adequate return. But any increase of profits to the pioneers and risk-takers has been transitory. In the long run the gains from higher productivity have been diffused through the whole nation in the form of lower prices than otherwise to consumers. In other words, we have increased the ratio of wages to prices.

7—The proposition that the whole increase in productivity brought about by a new or better machine should go to the particular worker who operates the machine is absurd on its face. It completely contradicts the principle of equal pay for equal work. Its application would give no incentive to any investor or employer to buy or build a machine, no incentive for progress, no gain for consumers. It would not merely be inflationary, but reactionary and disruptive. And no one would be worse hurt by it than labor itself. ❁



## Calling the Market Black

February 18, 1952

In the spring of 1947 I was a dinner guest in the home of a Cabinet minister of a European country that shall remain nameless. Generous portions of butter were served. "From the black market," volunteered my host. "*Everybody* in this country has to go to the black market for butter; nobody could get along on the official ration." And he seemed quite forgetful that he was a member of the government that had imposed a price and a ration that he himself felt forced to violate.

He was merely part of what has become an established world hypocrisy. Today bureaucrats try at nearly every point to stop the market process from functioning. Fortunately for production and trade, they are never completely successful. So they denounce the markets that they have illegalized, but cannot prevent, as "black."

But they have more respect for the black markets than they pretend. This was unconsciously revealed by Sir Stafford Cripps when he slashed the official value of the pound in 1949 from \$4.03 to \$2.80—and gave as his reason for choosing the latter figure the fact that this was the value the black markets of the world had been placing on the pound!

When free markets are forbidden, black markets become the best and often the only available guide to real values. If they did not exist, moreover, in many parts of the world the most essential commodities would either not be raised, made, bought, and sold at all, or only in far smaller quantities. Millions of people in the world today literally owe their very lives over the last dozen years to the black market, which is the only resort when price fixing has become too absurd, disruptive or intolerable.

It is high time the black market received the recognition it deserves. It gets it with the publication of *The 1951 Black Market Yearbook* by Franz Pick. Born in Czechoslovakia, educated at the Universities of Leipzig and Hamburg, Dr. Pick in 1945 started in New York a monthly report on world black money markets. His book lists the official and black-market fluctuations in the prices of dollars in the currencies of 54 countries, gold in 33 international trading centers, and of silver, platinum, and diamonds.

The book is dedicated "to the more than 2,000,000,000 victims of inflation, who, for obeying the law, have been punished by the law." It is full of fascinating tables, graphs, and other information. You can find here that at the end of 1951 the black-market value of the British pound was \$2.40 (compared with its official parity of \$2.80); that the black-market

value of the West German mark was 5.13 to the dollar (close to the official par of 4.20); that the German Eastern zone mark sold at 21 to the dollar; that black markets in American dollars flourish even in draconian Moscow, where the Russian ruble trades at 25 to the dollar (officially it is 4 to the dollar); that the Nationalist Chinese yuan had reached 425,000,000 to the dollar in September 1949; that the Chinese Communist dollar was 38,500 to the American dollar at the end of 1951, but the National Taiwan dollar in Formosa was less than 27 to the American dollar; and that in Cairo, gold sovereigns that bear the effigies of Kings, and not of Queens, are preferred by Mohammedan hoarders.

To these facts and tables Dr. Pick adds his own comments and predictions. His definitions are unconventional: Hoarders are "individuals who have no confidence in the skill of their country's monetary management, and who prefer illegal ownership of gold or hard currency to the legal expropriation by patriotic possession of paper money." Devaluation is "the unpunished crime of state bankruptcy."

Dr. Pick believes that the future of the dollar "is not as rosy as the hoarder in Buenos Aires or Shanghai sees it to be." He concludes that world inflation is likely to continue, and that "black markets are here to stay," because "more and more people will disregard existing regulations in order to preserve the remaining value of whatever possessions they may have." ❁

## Price-Control Follies of 1952

February 25, 1952

No one seriously expects that Congress will obediently extend price control for two more years, repeal the Capehart and Herlong amendments, and "strengthen" the Defense Production Act by giving the President the still more sweeping discretionary powers he now demands. What seems most likely to happen is an extension of substantially the present or a "weaker" price-control law for another year. But unless this is accompanied by stringent Congressional curbs (which are improbable) on further monetary inflation by Federal Reserve policy, Mr. Truman will have achieved the real purpose of his message, which is both to continue price control and to throw the blame on Congress for any further inflation.

The basic cause of inflation is the increase in the supply of money and credit. This increases most people's monetary purchasing power, cheapens the dollar, and forces up prices. Not once, however, does Mr. Truman's

message acknowledge this overwhelmingly dominant cause. True, after devoting seven-eighths of his message to the need for “strong price control” as the remedy for inflation, he does get around in the end to “other” (and presumably subordinate) “anti-inflation powers needed to do a completely effective job.” Even here, however, he throws his whole stress on the alleged need for curbing the kind of credit which is least inflationary—consumer installment credit. He says not a word about curbing the overall growth of bank credit, particularly the most inflationary kind, Federal Reserve credit.

What, then, is Mr. Truman’s own theory of the chief cause of inflation? It is almost impossible to tell from his message. He implies reasons that are clearly wrong, and then contradicts even some of these. He talks at times as if inflation were caused by “scarce supplies” of goods. This, however, is contradicted by the Federal Reserve Board, which shows industrial production at an index rate of 218 in January 1952, compared with 199 in June of 1950 and 109 in 1939. Moreover, he himself goes on to point out that “the wholesale price index rose 17 percent in the seven months from June 1950 through January 1951, and the consumers’ price index rose 8 percent”—when, as he adds, “there were no shortages of any kind.”

Then what caused the price rise? According to the President, “consumers” and “businessmen” went on a “buying spree.” But he never asks where they got the extra money for the buying spree. Had those who drafted his message looked up the figures, they would have found that in this same period when wholesale prices increased 17 percent, the country’s bank loans increased 17 percent; and in this same period when the consumers’ price index rose 8 percent, demand bank deposits increased 8 percent! It was this increased bank credit that financed the price rise.

In calling for “stronger” price control, Mr. Truman is particularly outraged by the Capehart amendment, under which price ceilings must allow for cost increases incurred between the Korean war outbreak and July 26, 1951. But his own examples prove how necessary this amendment is, in common fairness, if we retain the folly of price control. One product, he says, had to be granted a 5 percent price increase under the amendment, though the OPS had previously scheduled a 4 percent reduction. But this simply means that without the amendment the OPS would have blindly or ruthlessly imposed a further squeeze in the profit margin of a firm whose profit margin had already been reduced by rising costs!

His whole attack on the Capehart amendment reveals that Mr. Truman wants to use price control to

effect a political redistribution of income by cutting profits even below the pre-inflation level to make possible still higher wage awards by the WSB—the “Wage Stimulation Board.”

Price control is a fraudulent “protection” against the money inflation that the government itself permits or creates. Congress should force a halt to any further increase in the money supply, and let price control expire. ❁

## Footnote on ‘Statism’

March 3, 1952

In this excellent new book, *How to Keep Our Liberty* (see Books), my colleague Raymond Moley has a prefatory “Note on Terminology.” Like all of us who try to write sense on economic and political questions today, he is troubled by the strange perversions and reversals that have taken place in recent years in the meaning of words: A ‘liberal,’ as he points out, “was once a person who opposed the intervention of the state in the life and affairs of the individual. Now the word is used as self-description by those who favor such intervention.”

So Moley defines his own chief terms in advance. “Interventionism” accurately describes the trend toward a socialist state, but he thinks a shorter and better word is “statism.” He defines it as “a policy or philosophy that advocates a progressive trend of intervention by government in economic, social, and personal life.”

The term with this meaning fills a long-felt need. Moley’s own book, in fact, is largely devoted to counteracting the danger of statism, and we have to identify and label a trend or a philosophy before we can effectively combat it. But as Moley points out: “Recent use of the term [statism], mainly by opponents of the trend, has anticipated the lexicographers.”

I should like to supplement my colleague’s remarks on the word with a few notes of my own, as I happened to play a part in its adoption. I first became acquainted with the term “étatism” in the writings of the Austrian economist Ludwig von Mises, whose great book *Socialism* I reviewed in *The New York Times* in 1937. He used the term to mean “the doctrine of the omnipotence of the state, and, as a policy, the attempt to regulate all mundane affairs by authoritative commandment and prohibition.”

Though Mises probably did more than any other writer to establish the term and the meaning, neither was original with him, as I have since learned, but goes back some half a century. It was originally used by French critics of interventionism (*état* is the French

word for state). A chapter entitled Etatism is to be found as early as 1907 in a French book on individualism by Albert Schatz.

But while a word with the same meaning was essential in English, it seemed to me that etatism would be very difficult to popularize or even naturalize. A simpler solution appeared to be to translate "*etat*" into "state." But "state," in this country, is most often used as opposed to "nation" or "Federal." "Statism" might be thought to mean states' rights.

These objections did not seem too serious. But next came the problem of spelling—"stateism" or "statism"? The first involved a redundant vowel; the second ran the danger that the "a" would be pronounced, by analogy, like the first "a" in "statistician." Consulting the dictionaries, however, I found in my old edition of Webster's *New International*: "Statism (from State). Statecraft. *Obs.*" So it was simply necessary to revive an obsolete word with an established spelling and pronunciation and use it in the new meaning. I began using the word in that sense in this column and then in a book *Will Dollars Save the World?* published in 1947 and condensed in *The Reader's Digest*.

Whether I was anticipated by other writers in using the word in this sense I do not know. But there is an interesting epilogue. John Foster Dulles frequently used the term with this meaning in his New York Senatorial campaign of 1949. In the *Political Science Quarterly* of December of that year, Prof. Lindsay Rogers, puzzled by this use, looked the word up in the dictionary, found only such obsolete meanings as "statecraft," and assumed that people must be wrongly using it now because they did not know what it meant!

But if the enemies of liberty are allowed to pervert fine words to base meanings, surely the defenders of liberty have a much better right to develop a new word or meaning to describe and identify the great threat to liberty in our time. That threat is statism, the philosophy behind totalitarianism of every brand. ☸

## The Lull in Inflation

March 10, 1952

Evidence has been rapidly accumulating in recent weeks that inflation has come to a temporary halt. The government's old index of wholesale prices, which rose from 157.3 at the outbreak of the Korean war in June 1950 to a peak of 184 in March a year ago, had fallen in the week ended Feb. 19 to 174.8. The Dow-Jones daily spot commodity price index, which reached as high as 224.61 in February of last year, and as high as 197.85

in early December, had fallen by Feb. 27 of this year to 186.48. On the stock market, industrial shares have declined sharply since the middle of January.

The break in wholesale commodity prices has been pretty general. It has been particularly severe in grains, and in the metals and raw materials—copper, lead, zinc, wool, rubber—that went up most following the outbreak of the Korean war. The severe shortages of steel, aluminum, lead, and copper that appeared to exist a couple of months ago have been easing or disappearing. Spots of unemployment have developed. And in a few lines—cotton textiles, for example—there is a definite depression.

This decline has been the consequence of several main causes:

1—The expectation in recent weeks that a truce would be arrived at in Korea.

2—The deferment of government schedules on many war items.

3—Recognition that previous fears of shortages had been exaggerated. This has brought a halt to "inventory hoarding." In addition, the need of corporations for cash to pay income-tax installments, or for other purposes, has been causing them to reduce inventories or to sell part of them.

4—Profit margins are now being squeezed by price ceilings on one side and by higher taxes and higher wage demands on the other.

5—In recent months, the Federal Reserve authorities have ceased to follow inflationary policies.

It is the last factor that needs particularly to be emphasized. The banking system has not for a long time been buying long-term 2½ percent government bonds at par or better. On Feb. 20 the Federal Reserve Banks held \$22,400,000,000 of government securities, a reduction of \$1,250,000,000 from Jan. 2, and the lowest holdings since May of last year. Interest rates have been allowed to creep higher. The rate on short-term bank loans to commercial borrowers, for example, rose from an average of 2.68 in June 1950 to 3.27 in December 1951. The rate on long-term U.S. government bonds was allowed to rise from an average of 2.33 in June of 1950 to an average of 2.70 in December 1951. Total loans of reporting member banks of the Federal Reserve System were \$34,633,000,000 on Feb. 20, a decline of \$870,000,000 from Dec. 26, compared with an increase of \$278,000,000 in the corresponding period a year ago.

To sum up, what has been taking place is a lull in the inflation. The business and price readjustments that have been occurring are unavoidable whenever an inflation is allowed to come to a halt. If the government



is now content simply to let things alone; if it does not start pumping new money into the system; if Mr. Truman keeps Federal expenditures in the next fiscal year to the \$71,000,000,000 that he expects to raise from present taxes, and does not embark on a course involving a stupendous deficit of \$14,000,000,000; and if the War Stabilization Board does not precipitate a new round of wage increases by its steel decision, the inflation will halt in its tracks.

So the present situation is a test of the sincerity of the Administration, of Congress, of farmers and union members, and of businessmen. If they are really opposed to inflation they will not start taking or demanding desperate measures to keep it spiraling upward. The Administration will not ask for a continuation of price control, for there will be no longer any excuse for it. All that Congress will need to do is to remove the temptation from Federal agencies to start inflating again merely by removing their present powers to do so. (For details, see this column, Nov. 26, 1951.) ❁

## Case against Price Control

March 17, 1952

A year or so ago a leading Mexican banker wrote me that agitation for price control was rising in his country, and that those who favored it were citing the United States as the great example of how successful such controls had been in the second world war. Could I send him a list of the outstanding studies, pro and con? More recently, I received letters from students assigned to the negative of the topic chosen for national intercollegiate debate: "Resolved, that the Federal Government should adopt a permanent [sic] program of price and wage controls." These students had been referred to some of my *Newsweek* articles or to my *Economics in One Lesson*. Could I refer them to further literature against price controls?

The answer was not easy. In favor of government price control there were tons of official propaganda in all languages, and plenty of theoretical fireworks by academic statists and New Dealers. But analyses and documentation critical of price control, except those buried in legislative hearings, were appallingly scarce.

At last, however, a good critical literature on price fixing is beginning to emerge. I should like to speak here of three outstanding recent pamphlets: *Price Fixing for Foodstuffs*, by Earl L. Butz, head of the Department of Agricultural Economics at Purdue University (*American Enterprise Association*, 4 East 41st St., New York City, 17); *American Agricultural Policy during Rearmament*, by Karl

Brandt (*Food Research Institute: Stanford University, Stanford, Calif.*); and *The Price of Price Controls*, by the Committee on Economic Policy (*Chamber of Commerce of the United States*, Washington, 6, D.C.).

Every one of these pamphlets is opposed to price control, and each is excellent in the field it covers. They combine a sound theoretical analysis with telling illustrations and facts. They recognize that inflation is caused primarily by increase in the supply of money and credit, and that the way to halt inflation is to halt this increase. They all point out that free-market prices perform a vital function. "Price is the device that determines how we use our resources and how we distribute our national product. Prices tell producers what to produce and tell consumers what and how much to consume" (Butz). And they explain how price control destroys this guide. They show how price ceilings curtail and distort production, encourage wasteful consumption, create shortages, and necessitate priorities, rationing, and subsidies to make them work at all over any long period. They point out that price control inevitably means profit control and gives a government bureaucrat power of life or death over an industry.

They cite liberally from the absurdities of price control in the second world war. "A lumber producer testified," says the Chamber of Commerce pamphlet, "that his customers desperately needed one-inch boards, but due to OPA ceilings he could not sell these and break even, but he could sell three-inch boards and make a small profit. His customers were required to recut lumber to their specifications at increased cost." "Early in 1942 [writes Butz] some farmers were being fined 42 cents per bushel for wheat grown in excess of their quota, at the very same time their neighbors were purchasing 'feed' wheat from the government [imported from Canada] which was subsidized approximately 49 cents per bushel." Butz also points out that retail food prices have risen no more than factory wages since before the second world war.

### FOOTNOTE ON 'STATISM'

Since the appearance of my column of March 3 on "Statism," a correspondent has pointed out to me that the word "Stateism" was used in a speech in Omaha as early as February 1940 by Herbert Hoover. The former President there contrasted the concept of "Stateism with its political bureaucracy, directing, dictating, and competing with farmers, labor, and business," and controlling "price, wages, farms, . . . industrial output, and investment," with the concept of "a free enterprise regulated to prevent abuses." ❁



## Are These Handouts Necessary?

March 24, 1952

The whole foreign giveaway program—whether it is labeled “direct military aid,” or “defense support” (the latest euphemism for economic handouts), or Point Four—needs to be completely reexamined. In this task neither Mr. Truman’s message to Congress nor his radio and television appeal to the nation will be found of help. Both appeals were chiefly rhetorical and openly partisan.

Mr. Truman accused anyone who wants to cut his \$7,900,000,000 request by even a small amount as “demagoguing in favor of economy.” He resorted to inventing straw men as the only alternatives to his quixotic giveaway schemes. Straw Man No. 1 was to make “premeditated and deliberate war” on Soviet Russia. As no influential group in this country is proposing such a thing, it was recklessly irresponsible for Mr. Truman to feed Communist propaganda by talking as if there were one. Straw Man No. 2 was to “abandon our allies and hole up on this continent.” No influential group is suggesting this either; and it was equally irresponsible for Mr. Truman to give our European allies the false impression that there is such a group and such a proposal.

Neither Senator Taft nor former President Hoover has proposed that we repudiate the Atlantic treaty. And neither of them, nor any other serious person, has proposed that we actually cut off trade and stop buying necessary goods from the European continent. But a responsible body of opinion here has doubted that it is wise or necessary to pour heavy American land forces into Europe in peacetime and to give away as many billions to as many countries as Mr. Truman and his aides recommend. (We have giveaway—i.e., “economic”—missions today in 40 countries.)

Mr. Truman’s message and radio appeal were distinguished by self-righteous rhetoric, gross caricature of opposing views, and a contemptuous absence of facts. He assured the public that his figure of \$7,900,000,000 was “not just taken out of the air” but was “the result of many months of careful study.” But in his whole message to Congress he gave not the slightest hint of how the figure was arrived at. How much did the other NATO nations spend, individually and collectively, on defense and other items of their government budgets in the twelve months ending June 30, 1950? In the twelve months ending June 30, 1951? In the current twelve-month period? How much of their own money are they planning to spend for these purposes in the next fiscal year? What is the ratio of these sums to

their respective national incomes? And the ratio of their defense to other government expenditures?

Nowhere in a message of 7,000 words devoted solely to the subject did Mr. Truman find room to mention any of these figures. How did our bureaucrats decide how much European arms and goods it is up to us to supply? And above all, how did they decide that American taxpayers had to *give* these arms and goods to European taxpayers—that the latter just cannot afford to pay for any of these themselves?

When Mr. Truman’s message does venture into the realm of fact, we get a howler: “Europe has moved faster toward integration in the last five years than it did in the previous 500.” This is blandly said at a time when inter-European trade is sunk in currency chaos and tied up in the most vicious network of exchange and import controls in centuries!

Mr. Truman’s message is obscure even on the most basic facts. He is asking for “only” \$7,900,000,000, but his budget two months ago set down a total of \$10,500,000,000 for foreign aid. Presumably this is still the amount he actually plans to spend on foreign aid in the 1953 fiscal year. Why is there no mention of this fact in his message or radio talk? Again about \$7,000,000,000 is already available for foreign aid. If Congress does vote all the new funds requested by the President, then apparently some \$15,000,000,000 will be available all together for such aid. Why wasn’t this even mentioned by the President? Surely the subject needs clarification. ❁

## Inflation and High ‘Costs’

March 31, 1952

From Sept. 3 to Oct. 1 last year there appeared in this space a series of articles called “Inflation for Beginners” which have since been made available to *Newsweek* readers in the form of a pamphlet. These articles sought to explain how and why: “Inflation, always and everywhere, is primarily caused by an increase in the supply of money and credit.”

There was nothing peculiar or particularly original about my explanation. It corresponded closely, in fact, with “orthodox” doctrine. It is supported overwhelmingly by theory, experience, and statistics. It may be pointed out once again, for example, that the doubling of retail prices since 1939 has been primarily caused by the increase in the supply of money and credit (currency plus bank deposits) from less than \$65,000,000,000 at the end of 1939 to \$188,000,000,000 today.

But this simple explanation still meets with considerable resistance. The Truman Administration denies or ignores it, because it places responsibility for inflation squarely on its own doorstep. Few of the academic economists are helpful. Most of them are attributing present inflation to a complicated and disparate assortment of factors and “pressures.” Labor leaders vaguely attribute inflation to the “greed” or “exorbitant profits” of manufacturers. And most businessmen have been similarly eager to pass the buck. The retailer throws the blame for higher prices on the exactions of the wholesaler, the wholesaler on the manufacturer, and the manufacturer on the raw-material supplier and on labor costs.

This last view is still widespread. Few manufacturers are students of money and banking; the total supply of currency and bank deposits is something that seems highly abstract to most of them and remote from their immediate experience. As one of them writes to me: “The thing that increases prices is costs.”

What he does not seem to realize is that a “cost” is simply another name for price. One of the consequences of the division of labor is that everybody’s price is somebody else’s cost, and vice versa. The price of pig iron is the steelmaker’s cost. The steelmaker’s price is the automobile manufacturer’s cost. The automobile manufacturer’s price is the doctor’s or the taxicab-operating company’s cost. And so on. Nearly all costs, it is true, ultimately resolve themselves into salaries or wages. But weekly salaries or hourly wages are the “price” that most of us get for our services.

Now inflation, which is an increase in the supply of money, lowers the value of the monetary unit. This is another way of saying that it raises both prices and “costs.” And “costs” do not necessarily go up sooner than prices do. Ham may go up before hogs, and hogs before corn. It is a mistake to conclude, with the old Ricardian economists, that prices are determined by costs of production. It would be just as true to say that costs of production are determined by prices. What hog raisers can afford to bid for corn, for example, depends on the price they are getting for hogs.

In the short run, both prices and costs are determined by the relationships of supply and demand—including, of course, the supply of money as well as goods. It is true that in the long run there is a constant tendency for prices to equal marginal costs of production. This is because, though what a thing has cost cannot determine its price, what it *now costs or is expected to cost* will determine how much of it, if any, will be made.

If these relationships were better understood, fewer editorial writers would attribute inflation to the so

called “wage-price spiral.” In itself, a wage boost (above the “equilibrium” level) does not lead to inflation but to unemployment. The wage boost can, of course (and under present political pressures usually does), lead to more inflation *indirectly* by leading to an increase in the money supply to make the wage boost payable. But it is the increase in the money supply that causes the inflation. Not until we clearly recognize this will we know how to bring inflation to a halt. ☼

## The ‘Stabilization’ Hoax

April 7, 1952

Nothing has more clearly revealed the complete hypocrisy of the Administration’s so-called stabilization program than the Wage “Stabilization” Board’s decision in the steel case. The board granted the steelworkers’ unions practically every major demand of whatever nature. It awarded straight general wage increases of 17½ cents an hour, plus higher premium pay for workers on second and third shifts, plus reduction of geographical differentials, plus holiday pay and longer vacations. On top of all this, it recommended the union shop. Altogether, it is estimated that these changes would raise the steel industry’s direct labor costs by 25 to 30 cents an employee hour.

The industry itself estimates that these increases would cost the companies about \$1,000,000,000 a year, which would require an increase of about \$12 a ton in steel prices (now about \$110 a ton) to offset it. It is not believed likely that price officials will grant increases of more than \$5 or \$6 a ton at most. But no one denies that *some* increase in the price of steel will be unavoidable.

Yet Nathan P. Feinsinger, the Wage Board chairman, blandly assures us that its recommendations, if adopted, “would not start another round of wage increases or set a new pattern.” This statement is flagrantly contrary to fact and experience. Philip Murray has already revealed that he will now extend his demands to steel fabricating plants. We shall soon hear from other labor leaders. As three of the Wage Board’s industry members declared: “Rather than resolving disputes, it is creating more disputes; rather than combating inflation, it is creating more inflation.” In the Wright Aeronautical case, as they point out, the board’s recommendation even exceeded the original union demand.

Technically the Wage Board’s “recommendation” is not binding. But in plain fact the pressure on industry is such that the board’s decision amounts to one-sided

compulsory arbitration. The board solemnly tells the parties to the dispute to go ahead and arrive at its fore-ordained result by “collective bargaining”! This turns collective bargaining into a sham and a mockery. What is left to “bargain” on when the board has announced in advance that its decision is “in all respects fair and equitable”?

It is especially ironic and absurd, as the industry members of the board point out, that “the largest [wage] increases in history” should be recommended by a board “which purports to be engaged in stabilizing wages.” Worse, the board threw “the weight of the government in support of the proposition that employees should be required to join a union as a condition of holding their jobs.”

The board’s recommendations constitute compulsory arbitration for the companies but not, of course, for Philip Murray. He can simply threaten to strike if he does not get precisely the settlement he wants. And apparently no one in Washington questions the right of union leaders to bring the production of steel or anything else to a halt, even in wartime, unless their demands are met. As long as we grant legalized monopolies to industrywide unions, the only way we can prevent strikes is to give the union leaders just what they ask for.

Even if a sincere attempt were made to impose wage and price ceilings by a uniform rule, the economy would not be free and the controls would not work. But the existing situation is infinitely worse. Completely different standards and formulas are applied, and different agencies set up, to fix prices on the one hand, and to “stabilize” wages on the other. This process is a disguised and dangerous way of trying to effect a political redistribution of income. The insincerity of the whole “fight” against inflation is further emphasized by the objections of the Treasury and of Leon Keyserling to discontinuance of the inflationary bond-support policy by the Federal Reserve Board.

But Congress has one way out, before too much further damage is done. It can let the whole mess of price fixing and wage “stabilization” powers expire on June 30 next. ❁

## Price Fixing without Tears?

April 14, 1952

If the government does not increase the money supply, price ceilings are unnecessary. If the government substantially increases the money supply, price ceilings are futile. They represent a hypocritical effort by the

government to “protect” the consumers against the consequences of its own inflationary policies.

But price ceilings, though in the long run futile, are never harmless. They curtail and distort production, encourage wasteful consumption, and intensify shortages. They give a set of government bureaucrats life-or-death powers over industry. They are used as a political weapon to try to distribute economic favors and penalties. And when wage controllers and price controllers (usually two different sets of officials loath to recognize each others’ existence) try to push up wages and hold down prices, they put dangerous strains on the economy.

What Congress ought to do now, of course, is simple. It ought to allow the whole network of price fixing and wage “stabilization” to expire on June 30. The Controlled Materials Plan in its present form should expire with it. War contractors could be granted enough “tickets” to get priorities for the strategic metals or other raw materials they need for themselves or their subcontractors. The remaining supply of such materials would then be “allocated” by supply and demand working with free prices in free markets. Today the rationing and allocation problem is *created* by price controls. Arbitrary ceilings hold these materials below the prices to which free markets would bring them. This creates shortages both by reducing production and by encouraging wasteful consumption.

But confused economic ideas and the present political atmosphere combine to make it highly improbable that Congress will do anything so simple and sensible as to allow price-and-wage control to expire. Too many congressmen honestly believe that under present conditions price fixing is really necessary. Others will vote for its continuance for purely political motives. They are afraid of being accused of favoring the “profiteers,” and of refusing to give the President the “weapons” to “fight” inflation. They are afraid of being blamed if prices actually do continue to go up.

If price fixing is destined to be prolonged, therefore, at least two main safeguards are necessary to minimize all the harm which it would do.

The first is to extend the price-control powers only for a short term (not more than a year at most), and *in addition* to put several emergency triggers on their termination. Congress should provide that the price- and wage-fixing powers can be terminated at any time by a vote of either House of Congress or by Presidential proclamation. With Congress always in a position to terminate the powers, the control officials would have to pay constant regard to sentiment in Congress and refrain from arbitrary rulings in defiance of that sentiment. Mr. Truman, on the other hand, could not argue



that he was being forced to continue price fixing by Congressional edict, and his successor would be free to terminate the powers as soon as he wished.

But even more important would be an amendment to *deprive* the Federal government of *its present power to inflate*. This could best be done by depriving the central Federal Reserve authorities of their power to lower the rediscount rates or to order the purchase of government securities in the open market by the Federal Reserve Banks. (See this column of Nov. 26.)

If the Federal government no longer had the power to inflate, it would have no excuse for using its price-fixing powers to “combat” inflation. Prices would not rise (or at most very moderately), and therefore Congress would not be blamed for a price rise. Price-fixing powers would lose their popularity with the Administration, because they would be accompanied by deprivation of the power to inflate. In fact, in order to get back its power to inflate, the Administration might itself order termination of the price control law. But this action would educate the country in the real economics and politics of inflation. ☸

## It Is Happening Here

April 21, 1952

Mr. Truman’s attempt to justify his illegal act in seizing the steel industry was demagogic, intemperate, and full of distortions. Under his Wage Stabilization Board’s “fair and impartial” recommendations, he contended, “the steel workers would simply be catching up with what workers in other major industries are already receiving.” Well, according to government statistics, the workers in all manufacturing industries are earning an average of \$1.64 an hour and the steel workers an average of \$1.88 an hour. The workers in all manufacturing industries are earning an average of \$67 a week and the steelworkers an average of \$78 a week. How much more do the steelworkers have to get above the average in order to “catch up”?

Mr. Truman can’t be referring to living costs, because the earnings of the steelworkers have already gone up 13½ percent since the outbreak of war in Korea, whereas living costs have gone up only 11 percent. What is Mr. Truman’s catch-up formula? How does he let everybody catch up with everybody else and still pretend to hold wages down?

The moment Mr. Truman turns to prices and profits; he considers all talk of catch-up formula outrageous. He never tires of denouncing the Capehart

amendment, which is only a limited catch-up formula for price ceilings.

The President’s discussion of steel industry profits is a statistical nightmare. “The steel companies,” he says indignantly, “are now making a profit of about \$19.50 on every ton of steel they produce.” This is double nonsense. *After taxes* and other costs, as Clarence B. Randall, the president of the Inland Steel Co., has estimated, the steel companies in 1951 made less than one-third of this amount. And neither Mr. Truman’s \$19.50 nor the steel industry’s estimate of about \$6.50 was made on *every* ton of steel. Either figure is an *average*. Marginal companies have been making considerably less, and they would have to halt production if their narrower margins were wiped out.

The most glaring omission from Mr. Truman’s speech was of course his complete failure to mention the fact that his board’s order would establish compulsory unionism throughout the steel industry, compelling every worker in it to knuckle down to Philip Murray to hold his job

Let us glance back over the last twenty years and reexamine the economic ideology that has dominated the government, and the policies to which it has led. The New Deal began with the assumption that the unions—all unions—were so weak that they needed the paternalistic help of the government. It also assumed that unions could do no wrong. It compelled an employer, however small, to “recognize” and “bargain” with the union, however large, that once succeeded in getting the votes of more than 50 percent of his workers. No matter how unreasonable the demands made by a union leader, the employer was forced by law to “bargain” with him and him alone. This union leader was in effect granted a Federal certificate of monopoly.

But this is not all. The employer had to bargain “in good faith.” How does one bargain in good faith? Obviously, by making concessions. Even this is not enough. The employer must concede all the union’s final demands, whatever they are. For if he does not, the union will strike. And then, of course, it is not the union but the employer who, in Mr. Truman’s phrase, is guilty of being “willing to stop production.”

This is the baneful logic that has led Mr. Truman to his present course. Industrywide unions are Frankenstein monsters created by Federal law. They have the power to bring the whole industry of the country to a halt unless their demands are met. For there is no longer any way to combat a strike. The government has legally deprived the employer of whatever effective way he formerly had of combating a strike. He is not allowed to break off negotiations with the union—or



threaten to discharge strikers and hire other permanent workers in their place. The strike must succeed. If the employer will not himself yield to the union demands, the next step is for the government to appoint an "impartial" wage board to recommend that this is the only "fair and reasonable" thing for him to do.

Of course, if you are a New Deal President, you do not stop there. You know that if the companies are permitted to charge higher prices to pay the higher wages, the public will blame you for the higher prices. So your next step is to *forbid* the companies to ask higher prices while compelling them to pay higher wages. If the companies say no, then you seize and denounce the companies and blandly argue that no other course was ever possible. You contemptuously ignore the legal procedure prescribed by Congress. You seize private property without a shadow of legal authority on the contention that this is the only way to prevent a strike.

You pretend that this course is bold, though it is really pusillanimous. You take it because you have legally deprived yourself of all power to combat a strike, because you don't know how to stop it except by buying it off, by forcing employers to pay the ransom demanded and because, for political reasons, you have made the government completely subservient to union policy. Of course by buying off one strike threat, you reward it and buy yourself a hundred others. You leave yourself no way to solve these in turn except by seizing each industry successively until you have brought on some form of fascist-socialism.

The minimum legal lessons for Congress are plain. It must allow the President's price-and-wage-fixing powers to expire on June 30. No government can be trusted to use such powers wisely or impartially, and least of all the present one. Congress should also repeal altogether the Wagner-Taft-Hartley Act; but if it lacks the clarity and courage to do that, then it must at the very least withdraw the present legal compulsion on employers to recognize and bargain with industrywide unions.

There is only one alternative: Either we make it legally possible once more for a strike to be broken, or we yield completely to constantly mounting union demands. There is no other alternative and no longer any excuse for believing that there is one. ☸

## Toward Equality of Incomes?

April 28, 1952

We often hear of the "equalization of incomes" in England. We seem less aware that a similar

transformation has been going on right at home. But in measuring either the growth or "redistribution" of incomes there are many traps for the unwary.

On March 5, for example, *The New York Times* carried a long article by Will Lissner announcing a "social revolution" since the 30s. "The poor," he wrote, "have become better off. Where three out of four families had incomes of less than \$2,000 a year in 1939, only one out of three fell into that class ten years later. The well-to-do . . . have become more numerous. In the late '30s, one family in about 50 was in the \$5,000 and over income class. . . . In the late '40s, one family out of six. . . . Over the decade [that of 1939 to 1949] median family incomes rose from \$1,231 to \$2,949." And much more to the same effect.

As they stand, such comparisons, if not meaningless, are grossly misleading. They are in terms of "current dollars" (though this fact is not explicitly pointed out by Lissner), and the cost of living rose substantially in the decade selected (more than 70 percent, in fact), so that an income would have to go up at least that much in dollars in order to remain the same in terms of what it would buy. Not only is this readjustment not made in the foregoing figures; the reader is not warned of its need or given the basis for making it for himself. Yet without such an adjustment all sorts of statistical miracles are possible in any inflation. Today a Frenchman with the equivalent of \$3,000 is a millionaire in terms of his own francs.

There has, however, been a striking "redistribution" of incomes in the United States, as the recent studies of Simon Kuznets and others show. The full Kuznets findings are still [on] press, but summaries have already been made public by two of his colleagues in the National Bureau of Economic Research, Arthur F. Burns and Geoffrey H. Moore. I have room to cite only a few comparisons. The upper 1 percent of income recipients in the U.S. received 16 percent of the countrywide total income in 1913. 17 percent in 1929, and 9 percent in 1948. How substantial the shift has been between 1929 and 1948 can be shown by one comparison. To achieve perfect equality of incomes, the share going to the upper 1 percent could have declined only 16 points (from 17 percent to 1 percent). But it actually declined by 8 percentage points, or half the mathematically attainable maximum.

How did this shift occur? Analysis can give at least part of the answer. Most wealthy people receive a relatively large portion of their income from property rather than from salaries. In 1929, for example, the upper 1 percent received 32 percent of their aggregate income from dividends, interest, and rent. Now on a per capita

basis, employee compensation increased 134 percent between 1929 and 1948, “entrepreneurial” income 145 percent, rental income only 26 percent, and dividends only 6 percent: while interest payments per capita actually declined 21 percent.

Higher money income per capita is of course always desirable to the extent that it means a real increase in purchasing power. But whether greater *equality* of income is desirable or not may depend largely on how it is brought about. To the extent that it depends on *maintaining* artificially low interest rates, it is dangerous because such interest rates create and continue inflation. To the extent that it depends on holding down rents to uneconomic levels it means that in the long run not enough housing will be built or kept in repair. To the extent that it is brought about by excessive corporation taxes and excessive personal income taxes on the higher brackets it will undermine and eventually destroy incentives to the investment and production on which we all depend. But to the extent that it is brought about by a real increase in productivity on the part of the lower income groups it is not only wholly desirable, but tends to be solid and permanent. ❁

## Perónism and Trumanism

May 5, 1952

Strangely little attention has been given to the striking parallel between the economic and political policies of President Truman, culminating in his seizure of the steel industry, and the economic and political policies of the Argentine dictator Perón, culminating in his seizure of the newspaper *La Prensa*. Yet the parallel has been underlined by Mr. Truman himself. Asked whether he could also seize newspapers under his “inherent powers” doctrine, he replied that a President has the power to do anything that (presumably in his own judgment) is for the best interest of the country. A week later, while denying any intention to seize the press, Mr. Truman reaffirmed his power to do so in an “emergency.”

The parallel is even more striking because both seizures were made on practically the same excuse. Mr. Truman contends that his seizure of the steel industry was the only way to prevent a strike; Perón contended that his seizure of *La Prensa* was the only way to settle a strike. Mr. Truman’s way of preventing a strike was to order the employers to pay a thumping wage increase, Perón turned *La Prensa* directly over to the unions. Yet Perón took pains to act with more color of legality than Mr. Truman. He did not seize *La Prensa* by his

personal ukase. He asked for, and got, a Congressional law authorizing the seizure.

The parallel may be extended. Neither Perón nor Mr. Truman has any faith in free enterprise or free markets. Both want to fix prices; both want to dictate wages. Each gives as his excuse for this that he is “fighting inflation”—the very inflation that his own monetary and fiscal policies have created. (Since Mr. Truman became President in April 1945, the money supply of this country—adjusted deposits plus currency—has been increased from \$138,000,000,000 to \$183,000,000,000. Since Perón became President in 1946 the currency of Argentina has been increased from 2,581,000,000 pesos to 17,704,000,000 pesos.) Each poses as the champion of the “underprivileged,” the *descamisados*, the “shirtless.” Each courts and subserves the unions.

What has caused this parallel to be overlooked is the persistence of the spurious interpretation that Communist propaganda long ago imposed on Western intellectuals. This is that Fascism is essentially a movement of the conservatives of the Right—“the last desperate effort of capitalism to save itself.” This interpretation has from the beginning ignored the open facts. Fascism, Nazism, Perónism, have all been bitterly hostile to “plutocracy” and to “laissez faire capitalism.” None of them tolerates free prices, free wages, free markets. They demand government control of wages, prices, profits, dividends, interest rates, investments. “Nazism” is, we should not forget, merely a contraction of the official title, National *Socialism*—or, more completely, the “National Socialist German Workers’ party.”

It is a groundless myth that German labor was from the beginning opposed to Hitler. As Ludwig von Mises wrote in *Omnipotent Government* in 1944: “Although the closed-shop system was not carried to the extreme in Weimar Germany that it is today in Nazi Germany . . . it had gone far enough. . . . [The worker] had to join one of the unions. . . . German labor was not greatly disturbed when the Nazis finally forcibly incorporated all trade-union members into their Labor Front.” It was too late when German labor at last became disillusioned—when it found that by gleefully conniving at Hitler’s crackdown on employers, it had put its own neck in the noose.

We need not labor the moral. American workers and American intellectuals have been off guard for the last twenty years, because they have been looking for the danger of fascism from the wrong direction. If they acquiesce in lawless action now, because it is taken in the name of unionism, of jacking up wages and slashing “outrageous” profits, they’ll deserve precisely what’s

coming to them once they have allowed the doctrine of executive omnipotence, above the law, to establish itself. ☸

## We Took a Wrong Turn

May 12, 1952

In the course of his opinion holding that the seizure of the steel industry was illegal, Judge David A. Pine pointed to some of the presuppositions behind the Administration's argument:

"Assuming the disastrous effects on the defense effort envisioned by the defendant, that can come about only in case of a strike, and that presupposes that the United Steelworkers will strike notwithstanding the damage it will cause our defense effort. It also presupposes that the Labor Management Relations Act, 1947, is inadequate when it has not yet been tried, and is the statute provided by Congress to meet just such an emergency. And it further presupposes, as defendant apparently does, that, this statute being inadequate, Congress will fail in its duties, under the Constitution, to legislate immediately and appropriately to protect the nation from this threatened disaster. I am unwilling to indulge in that assumption. . . ."

Judge Pine might have mentioned still another unstated presupposition in the Administration's argument. This is that when the head of an industrywide union threatens to bring a whole industry to a halt unless his demands are met, there is no way to counter his threat; we must simply hasten to grant his demands. The Administration has come to regard it as unthinkable that a strike should be allowed to fail, or that employers should have once more the freedom that they had prior to the passage of the Wagner Act to discharge strikers and peaceably hire other workers in their place.

And Congress has made itself impotent by its own legislation. It has put in the hands of irresponsible private individuals the power to bring the whole industry of the country to a halt. And instead of acting to take such power out of these hands. Congress treats the strike orders of a Philip Murray or a John L. Lewis like some inescapable "national emergency."

The truth is that twenty years ago the whole labor policy of the country took a wrong turning. Congress was sold the one-sided idea that there was only one cause of labor disputes—unfairness to labor. On that assumption it concluded that there was one all-sufficient cure for labor disputes, which was to make every union stronger, to strengthen its bargaining position further, to help it to win strikes or prevent it from losing them.

It put more legal weapons into the hands of union leaders at the same time as it illegalized counterweapons by the employers. In 1932 it passed the Norris-LaGuardia Act (reputedly drafted by Felix Frankfurter) which put paralyzing restrictions on the right of the Federal courts to grant injunctions against strikes and strike practices.

The next major step of Congress (after the temporary Section 7a of 1933) was the Wagner Act of 1935. Under this the government itself was in effect set up as a union organizing agency. It provided the election machinery. It named the "appropriate bargaining unit." It threw any "company-dominated" union off the ballot—which seemed to mean, in practice, any union that could be shown to be on friendly terms with the employer or that was not affiliated with the AFL or the CIO.

Under this government tutelage union membership was built up from about 4,000,000 just prior to the Wagner Act to some 15,000,000 today. Industrywide unions have been legally granted the right to cripple the nation, even in time of war.

What is urgently needed now is not *ex-post-facto* authorization by Congress for further industry seizures by the President, but fundamental revision of our whole labor policy of the last twenty years. No private organization can be allowed to retain the power to coerce the public by paralyzing industry. Congress should clarify the antitrust laws as applied to labor unions. It should drastically revise the Norris-LaGuardia Act. And it should restore the provisions in the Taft-Hartley Act as originally passed by the House (they failed to carry by only a single vote in the Senate) which removed the compulsion on employers to bargain with industrywide unions. ☸

## The Philosophy of Seizure

May 19, 1952

Where did Washington ever pick up this preposterous notion that the way to prevent or settle industrywide strikes is to seize the property of the victims of the strikes? The idea was not born in the last few weeks. The late "Clear-it-with-Sidney" Hillman told a special committee of the Senate in April 1941, when strikes were crippling our defense plants, that he opposed any legislation that would interfere with unions but would favor government seizure and operation of defense plants closed by strikes. Even prior to this, under Section 9 of the Selective Service Act of 1940, Congress had given the President statutory authority to seize war facilities. Franklin D. Roosevelt began seizing the plants and



properties of employers whenever an important strike occurred in them.

In June of 1943, John L. Lewis called a coal strike against a decision of the War Labor Board and offered to call it off only if the government would seize the mines and operate them itself. Then on June 25, 1943, Congress passed the Smith-Connally "antistrike" act, over the President's veto, which again authorized government seizure of war facilities, but with the restriction that any plant so seized "shall be operated under the terms and conditions of employment which were in effect at the time possession was taken." One sequel to this was the seizure of Montgomery Ward in April 1944, when President Avery was carried bodily out of the plant.

According to one private score card, President Roosevelt ordered the seizure of four aircraft-manufacturing companies, three shipyards, all the railroads, all the coal mines, several utility companies, dozens of motor-transport companies and more than 150 industrial plants and shops. Of the 48 seizure orders he issued, 41 were to enforce labor demands. The Truman seizures have covered anthracite and bituminous coal mines, oil refineries, pipelines, packinghouses, railroads, and traction systems. And he ordered all of them ostensibly to stop or to prevent strikes. On this excuse the government has been "in possession" of the railroads of the country for 21 months (since Aug. 27, 1950).

What gives the idea of seizure its strange appeal? The legal logic behind it is too confused to follow. Why should it be perfectly all right to bring the steel output of the country to a halt if private investors own the plants, and wrong only if the government "owns" them? Production is just as crippled, and the national safety as much imperiled, in the first case as in the second. The theory seems to assume that government does not exist to protect the property and interests of citizens, but only to protect its own property and interests. You can strike against the public safety but "you can't strike against the government," yet even on this rear-end-first theory, seizure rests on a legal technicality, even on a legal fiction. For the government "owns" the property only for the purpose of settling a strike. And the strike is settled, not because workers fear to strike "against the government," but because the government manager offers the strikers, out of other people's money, substantially the increase they asked for.

This is the real motive behind the seizure policy. It is the product of a statist and socialist philosophy, it assumes that private employers can't be depended on to pay "fair" wages, so the government must seize their property and force them to do so—knowing, of course,

exactly what "fair" wages are. In the railway strike crisis of 1946, Mr. Truman even went before Congress to propose a measure under which: (1) When a strike occurred in an essential industry the essential industry was to be seized by the government; (2) under such seizure the President was to "establish fair and just wages"; but (3) the property owners were to be denied any profits!

Government seizure abridges property rights, rewards strikers, and penalizes the struck-against. Its real purpose is to impose a government-dictated wage increase. The threat of it is used not to restrain the demands of union leaders but to force employers to grant them. It destroys free collective bargaining. And it creates the very crisis it professes to solve. ❀

## Inflationary Double-Talk

May 26, 1952

At his press conference on May 8, Mr. Truman, asked whether the chief danger was inflation or deflation, replied that the country had to guard against both: and that was why it was necessary to have control powers—to prevent either one.

There is nothing new in this Scylla and Charybdis analogy. It runs like a refrain through the speeches of Leon Keyserling and the reports of the Council of Economic Advisers since that body was created. What is significant is Mr. Truman's own espousal of the doctrine at this time. On top of the hasty removal of restrictions on the use of "strategic" metals, on state and local bond issues, on housing, on real-estate credit, and especially on general installment buying, on top of the violent denunciations by Administration spokesmen of every effort of Congress to economize at any point, this statement makes it unmistakably clear that what the Administration really fears and fights now is any lull in the inflation, any sag in the boom prior to election. In brief, it is prepared to throw all its "anti-inflation" policies into reverse.

It would of course serve Mr. Truman's political purposes ideally if he could get Congress to swallow this fighting-both-devils-at-once doctrine. He could then continue both to inflate and to "fight" his own inflation. He could step on the accelerator of credit expansion with his right foot while he stepped on the resulting price increases with his left—always saving the country in the nick of time. The politicians of Europe have made a very good thing of this. The result is known there as repressed inflation.



The principal methods by which governments inflate are: (1) huge governmental spending, particularly deficit spending; (2) monetizing the public debt; (3) pegging or forcing down interest rates; (4) ordering wage boosts; and (5) encouraging private credit expansion. The Truman caliphate has resorted to all these methods. The principal methods by which governments pretend to “fight” inflation are by price fixing and wage fixing, usually accompanied by allocations, rationing, and subsidies.

These two sets of powers give a government unanswerable weapons for punishing political opponents (by crushing taxation, price rollbacks, profit cuts, inadequate allocations, seizures) and for rewarding political supporters (by favorable allocations, price or profit increases, wage increases, and subsidies). Through its life-and-death powers over everyone’s economic prospects, it has the power to keep everybody in line.

Politically attractive as such powers are to a ruling clique, they make no sense economically. They imply that a free economy cannot balance itself, but that the DiSalles and Arnalls and Feinsingers know just how to do it. They imply that inflation is some disaster that falls upon a country from the outside, like a flood or a plague of locusts. Inflation is in fact always and everywhere the creation of governmental policy. It is caused by the increase in the supply of money and credit. The way to halt it here is not to give the President “emergency” powers to halt it, but to *deprive* him of his present power to inflate. That the Administration knows how effective this deprivation would be is evident from its vehement objections whenever any proposal arises in Congress to free the Federal Reserve System from Treasury dominance.

As for price control, it cannot be repeated too often that as a cure for inflation it is completely fraudulent. It not only diverts attention from the real cause and cure of inflation. It adds further evils of its own. It abridges human liberty, encourages waste, and disrupts production.

The course before Congress is clear. It should allow price-control and wage-control powers to lapse completely. It should deprive the Administration of its present power to inflate. And it should repeal the provisions in its labor laws which compel employers to bargain with industrywide labor monopolies and which give those monopolies the power to bring the nation’s production to a halt. ☸

## Stabilization or Redistribution?

June 2, 1952

What Mr. Truman calls a “stabilization” program has become in reality a program that attempts to redistribute income.

Since the end of 1939 the government has tripled the supply of money and bank credit. This has been the real cause of the rise in prices. When the money supply is not increased, price control is unnecessary. When the money supply is greatly increased, price control is futile.

As price control is unsound in principle, no formula for it can ever be right. But some formulas are more harmful than others. For present purposes we may distinguish two main approaches, which I shall label respectively the Baruch plan and the Truman plan.

The plan proposed by Bernard Baruch in the summer of 1950 called for “an overall ceiling across the entire economy.” All prices, wages, rents, and fees were to be rolled back to and frozen as of June 25, the day Korean hostilities broke out. This proposal was inspired by fine intentions. But as I pointed out in *Newsweek* of Sept. 11, 1950, it was economically unworkable and politically impossible. It ignored the whole function that prices, wages, and free markets play in our economy—which is to keep a balance among the output of thousands of different commodities and services, directing production into those that are most needed and away from those that are less needed.

The Baruch Plan would have frozen for war conditions the price and wage relationships that had been adapted to peace conditions. It would have removed every market incentive to change production over to the needs of rearmament. It would have required, instead, a completely totalitarian economy, with the government assigning detailed production and employment quotas, telling every company what to make and every worker what to do.

If carried out consistently, the Baruch plan would have meant that no worker could increase his hourly wage beyond the level at which it stood on June 25, 1950. Demands would have come from every side for the correction of “hardships” and “inequities.” But the moment we began to make these corrections we would be out of the Baruch plan and into the Truman plan. For what constitutes a “hardship” or “inequity” is a matter of opinion. And government inevitably defines “inequities” not in economic but in political terms. The decisions most likely to be made are those that can command the most votes. Politically speaking, profits and prices (except, of course, farm prices) are always too high and wages are always too low. So “correcting inequities,” as

I predicted here on Sept. 11, 1950, “becomes an excuse for holding down prices while permitting or encouraging wages to rise.”

And it is as a political device that Mr. Truman has used his price- and wage-control powers from the beginning. He and his agencies have demanded catch-up formulas for wages while denouncing even partial catch-up formulas for prices. Though hourly steel wages had already gone up since Korea more than the cost of living, though they were already 14 percent higher than the average of all manufacturing wages, Mr. Truman discovered that steel wages needed still another rise of 14 percent on top of this to “catch up.” But he becomes outraged whenever he speaks of the Capehart amendment, which allows sellers to pass on in prices any additional expenses up to July 26, 1951.

If Congress were now to insist that the same standard be applied to both price and wage control, then either each price would be allowed to go up as much as the cost of living goes up (which would increase the cost of living still further), or wages would not be allowed to go up any more than the cost of living had gone up prior to July 26, 1951—no matter how much further it goes up hereafter. But if Congress continues the President’s existing power to boost wages and to squeeze prices and profits, and adds authority to seize industries, the end result must be to disrupt production and to destroy free enterprise. ❁

## How Europe Curbs Inflation

June 9, 1952

I have been meaning for weeks to discuss here a remarkable address, now available in pamphlet form, delivered in New York on Jan. 23 by Per Jacobsson, the economic adviser of the Bank for International Settlements at Basle (“Credit Policy: Recent European Experience”; National Industrial Conference Board; 247 Park Avenue; New York 17; 50 cents). This speech describes a gradual return toward monetary sanity in Europe that few Americans seem to be aware of.

At the end of the first world war most countries were eager to return quickly to stable currencies and to the gold standard. But after the second world war, under the influence of Lord Keynes, they preferred cheap money and deficit spending. This, they supposed, was the secret of perpetual “full employment.”

Keynes’s influence, however, was never as great on the continent of Europe as in England and America. “The continental peoples,” Per Jacobsson explains, “have been faced more immediately with the evils of inflation.

They have learned to dislike controls. The imposition of controls has been very closely connected with the Nazi and Fascist regimes.” And contrary to the belief so widely held in 1945 and 1946, that between a capitalist United States and a Communist Russia there would stand a socialistic Europe, Europe has in some respects shown itself to be more “liberal in the sense in which Europeans still use this word—indicating adherence to and belief in a free economy—than either of the two principal Anglo-Saxon countries.”

Jacobsson then goes on to describe the monetary and fiscal policies followed in each of the leading European countries. Switzerland led the departure from cheap money, and the free-market quotation of the Swiss franc was for several years above the corresponding quotation of the dollar. Belgium followed sound policy and soon achieved monetary stability. It was criticized, particularly in England, for permitting unemployment; but Belgian workers supported the policy as holding down prices and helping them to achieve higher real wages.

In Italy, by 1947, prices had risen to 55 times the prewar level. But then—Einaudi, as Governor of the Banca d’Italia and Minister of the Budget, raised interest rates, imposed severe credit restrictions, and cut off all food subsidies. These seemed harsh measures—but they stopped the price rise.

“In the following year Einaudi was almost unanimously elected President of the Italian Republic.”

Following a crisis in Germany in October 1950, the discount rate of the Bank Deutscher Länder was increased from 4 percent to 6 percent. Ordinary bank accommodation could be obtained only at rates between 8 and 12 percent. “It was soon found that the program . . . adopted in Germany was working wonders. . . . The success of the German rehabilitation scheme has had a tremendous effect upon European thinking: It has shown us that a country as burdened with difficulties as Western Germany can, through a resolute credit policy, suddenly reverse its position.”

Jacobsson discusses similar changes in Holland and Austria. Since he spoke in January, policies in the same direction have been adopted in France and Britain. On March 11, for example, the Bank of England increased its discount rate from 2½ to 4 percent.

From this international postwar experience Jacobsson draws some of the principal monetary morals. One is the importance, in curbing inflation, of “a restrictive credit policy including the application of higher interest rates. . . . Of particular importance has been the withdrawal of support for the quotations of government bonds. “The first duty of the [U.S.]

authorities toward the world," he adds, "is to maintain the greatest possible stability in monetary and price conditions inside the United States."

Yet both the President and Congress have been heedless of these lessons. Mr. Truman has been busily removing credit restrictions at the same time as he insists on continued price control. Yet with firm credit policies price control is unnecessary; and without them it is a pious fraud. ❁

## Seizure Is No Solution

June 16, 1952

The decision of the Supreme Court that the President's seizure of the steel industry was illegal and Mr. Truman's prompt return of the companies to their owners averted a grave constitutional crisis. But as I write this we are back not only to the immediate problem of how to settle the renewed steel strike, but to a larger problem: What can we do about the present ability of nationwide unions to slow down or halt all industry unless their demands are met?

As a solution to this problem, most of the proposals now before Congress are not reassuring. For they propose to give the President the very seizure powers he usurped. They propose to tell him, in effect, that he was right in the first place—that what was wrong was not his policies, but existing law. They would simply give him the power to do legally what he had done illegally. They would give him the power to repeat with every industry the course he followed with steel.

That course may be summarized as follows: (1) When an industrywide union makes a set of demands, no matter how extravagant, they are turned over to a governmental board, packed with "public" members favorable to the unions, for decision. (2) The board then decides that the industry should grant the union demands practically in full—even though this makes a joke of all the previous "stabilization" standards of the board itself. (3) The union leaders and the President then treat this decision as unilateral compulsory arbitration, completely binding—on the employer. (4) If the employer fails to grant the board's awards in full, his plant is seized by the President, who then imposes the wage increases, compulsory unionism, or other awards of the board.

The tacit assumption behind Mr. Truman's whole policy, in short, is that there is only one way to prevent or settle a nationwide strike, and that is to grant practically all union demands.

Such a policy has exactly the opposite result of what the President contends. It "prevents" or "settles" a present strike only at the cost of buying a hundred future strikes. For it amounts to a capitulation by employers, government, and public to every major union demand. It rewards extravagant demands; it rewards strikes and strike threats. Under it the unions obviously get more by striking or threatening to strike than by not doing so. Mr. Truman's policy, in brief, creates the very evil it purports to avert.

A sound solution lies in precisely the opposite direction. It is to stop governmental encouragement of strikes and governmental rewards for striking. It is to take away from union leaders the special immunities and sweeping monopoly powers that have been deliberately conferred on them by Congress. A thoroughgoing reform would involve the repeal or drastic revision of the Norris-LaGuardia Act of 1932, which makes the granting of a private plea for a strike injunction practically impossible, even where union intimidation and coercion are involved, and the repeal or drastic revision of the Wagner-Taft-Hartley Act, which in effect turns the government into a union-organizing agency. The minimum change would be to restore the provision in the Taft-Hartley Act, as originally passed by the House, which removed the compulsion on employers to bargain with industrywide unions.

Mr. Truman's high-handed seizure of the steel industry raised a larger and deeper issue, which even an adverse six-to-three decision of the Supreme Court did not remove. This is the danger to our free-enterprise system of the hostility to it shown by the President, not only in his steel seizure, but in his incredible onslaught of May 26 against the public utilities, in which he threatened to invoke the Corrupt Practices Act against them for having the audacity to defend themselves against his attacks. Such governmental hostility, if long continued, must inevitably undermine confidence and discourage and choke off new investment. If that happens, the free enterprise system will have been effectively destroyed. It is up to Congress to erect safeguards against the execution of such demagogic threats. ❁

## Seizure Creates Strikes

June 23, 1952

Never has a rebuff to a President been so unmistakable, so prompt, and so richly deserved as that dealt by the Senate to Mr. Truman after he had asked Congress to let him continue to flout the Taft-Hartley Act and to give him industry seizure powers instead. And nothing



has so clearly revealed why Mr. Truman can *not* be trusted with such powers as his argument in favor of them.

Congress, he says, should “encourage the parties to settle their differences through collective bargaining.” But it is precisely his own plan that destroys collective bargaining. When both parties know in advance that their dispute will eventually be turned over to “special [governmental] boards to work out specific proposals” for settlement, then neither party will offer more or accept less than it thinks the special boards will demand of it or award to it.

But Mr. Truman blandly talks as if he can have free collective bargaining and compulsory arbitration at the same time—or even as if they were the same thing! The law he asks for is “to provide for fair and just compensation to the owners for the use of their property during a seizure, and fair and just compensation for the work of the employees.” And this government profit-fixing and government wage-fixing is the way to “increase the incentives for the parties to settle their differences through bargaining”!

Mr. Truman professes to want “sound price and wage stabilization policies” at the same time as he endorses the huge increases awarded to the steel-workers by the Wage Stabilization Board. But before their strike the steelworkers were already receiving an average of \$1.88 an hour, compared with an average of \$1.64 an hour in all manufacturing industries; steel wages had already increased 20 cents an hour since the Korean war outbreak, compared with an average increase in all manufacturing industries of 19 cents an hour; and steel wages had already gone up in the same period by 12 percent, compared with an 11-percent increase in the cost of living. Even the wage increases and other terms that have already been offered by the steel companies—and rejected by Philip Murray—would rip through the so-called stabilization ceilings and let loose a flood of demands for increases in other industries.

In spite of the constitutional provision that the President “shall take care that the laws be faithfully executed,” Mr. Truman still seems to think that his duty is limited to enforcing only those laws that he happens to like. He tells Congress that for him to apply the Taft-Hartley procedures at this time would be not only “unwise,” but “grossly unfair,” “harmful and futile”; that a court might not grant an injunction anyway, and that even if it did “there is no assurance that it would get the steel mills back in operation.” As Senator Taft has pointed out, these words are “practically an invitation” for the workers to violate the law.

And if the unions would strike even after a Taft-Hartley injunction, why wouldn’t they also strike even after government seizure? The President’s implied but unspoken answer is—because he expects to grant them, at the companies’ expense, the wages and other terms they demand.

Mr. Truman’s seizure solution would, in sum, create the very strikes and strike threats that it professes to cure. It would mean the imposition on industry of the strikers’ terms; and unions would threaten to strike to bring about this very result. It would make a mockery of wage “stabilization.” It would turn price-and-wage control into a political weapon. It would entrench industrywide unions. It would impose compulsory union membership on every worker. It would undermine free enterprise and eventually injure workers most of all.

The real solution, to repeat, lies in the opposite direction. It lies in allowing price-and-wage control to lapse. It lies in having Congress reverse the course it has pursued for the last twenty years—by removing the sweeping grants of monopoly power it has conferred on union leaders. ⚙

## Why Not Try Capitalism?

June 30, 1952

The other night I saw the new British film, *The Man in the White Suit*.<sup>\*</sup> It is a comedy with rare merits. (See the review in *Newsweek*, April 14.) But it is based on the implicit acceptance of an immemorial economic fallacy—the belief that new inventions destroy jobs and disrupt the economy.

A brilliant but erratic chemist, according to the story, develops a synthetic fabric that will neither stain nor wear out. But as soon as government officials, textile industry leaders, and the textile workers get wind of the discovery, they combine in their determination to suppress it. They argue eloquently (and no one in the film attempts a real answer) that once suits and dresses of the new material are put on the market, nobody will have to buy more than one, and that thereafter the whole textile industry will practically cease to exist, with a consequent permanent loss of capital and employment.

Let’s overlook its convenient forgetfulness of such sources of demand as style changes, personal size changes, and the desire for a varied wardrobe, and grant the picture’s central assumption that the invention of a stainless and wear-out-less fabric would permanently reduce the demand for clothing to, say, one-tenth of its present level. Then consumers would spend on clothing



only one-tenth as much, say, as they do at present. This means that they would have the remaining nine-tenths left over to spend on other things—more and better food, housing, furniture, roads, parks, gardens, entertainment, education, travel. The workers dropped from the textile industry would be absorbed in other industries to produce the added commodities demanded from those industries. As mankind could meet its needs with less effort, the working week might be still further reduced.

These consequences are not a theoretical dream. They are what has always followed historically from each new invention. Less than a generation after the introduction of Arkwright's cotton-spinning machinery, forty men were employed in the production of cotton textiles for every one that had been employed before. Nylon already represents today something close to the material of which the white suit was supposed to be woven. It makes, for example, a nearly indestructible man's sock. But it has helped, not hurt, the textile industry. And the cotton growers and silk producers were not able to do anything to prevent its development, production, or sale.

But an even more conclusive answer to the convictions and fears of everyone in the *White Suit* picture is supplied by the tire industry. Here is an industry, consisting mainly of big units, that constantly increased the life and durability of the product, constantly improved the quality, and constantly lowered the relative price. Some of us can still remember the days when a man who went out for a Sunday drive would reconcile himself in advance to one or two flats before he got home. Here is the startling record, over forty years, of the increasing average number of miles of life of a tire, and the decreasing cost per hundred miles of wear of a "Ford size" tire:

Years	Miles of Life	100-Mile Cost
1910	3,500	87 cents
1920	10,000	23 cents
1930	15,000	5.0 cents
1939	27,700	5.3 cents
1947	34,000	4.2 cents

Tire quality, safety and durability are still being improved. Yet where only 2,300,000 tires were sold in 1910, 30,000,000 were sold in 1920, 59,000,000 in 1940, and 100,000,000 in 1950. More tires were sold, it is true, because there were more automobiles. But better and cheaper tires helped to make better and cheaper—and therefore more—automobiles.

Economic and technical progress does not destroy jobs, and capitalism (contrary to the implication of *The Man in the White Suit*) does not oppose or retard economic and technical progress. On the contrary, capitalism—the system of free, competitive enterprise—is the indispensable condition of maximum economic and technical progress.

[\*The title of the film was corrected in the following week's column to *The Myth in the White Suit*.—Ed.] ❁

## The Fallacy of Point Four

July 7, 1952

Two items in *The New York Times*, published nearly a month apart, combine to throw a brilliant light on our foreign handout program.

June 16: "The United States will have given away or lent an estimated \$40,000,000,000 or more in postwar foreign aid by the end of this month. . . . More than 90 nations and colonies have received military equipment, economic aid . . . and a thousand other items. . . . Even Communist Russia, Czechoslovakia, and Poland were cut in for \$1,000,000,000 before the 'cold war' developed . . . The end is not yet in sight."

May 19: "Western leaders . . . are worried about the lack of any clear signs of improvement in production . . . and in the necessities of life in the non-Communist underdeveloped areas. . . . The only characteristic [of the West] that the Asians have shown they really want to copy is its technical knowledge and its application of mechanical power to the production of goods and services. . . . These leaders also believe that . . . the West . . . must devote very much more of its . . . wealth . . . to the instigation of economic progress in the vast poverty-stricken regions of the non-Communist world."

The American advocate of Point Four aid shares this in common with the Asiatic politician who receives it—that neither understands what makes capitalism so enormously productive. It is not "technical knowledge" or the "application of mechanical power." These are among the *results* of capitalism, not its causes. It is capitalism that produce[s] the machines that produce consumers' goods. The cure for the poverty of Asia, in brief, is not handouts from the capitalistic United States; it is the adoption of the philosophy of capitalism by Asia.

Capitalism is a set of economic and political *principles* and institutions. It consists of the marriage of liberty and security. It means freedom to produce and consume, freedom to buy and sell. It means free prices and free markets. With these freedoms it combines the

institution of private property; under which a man is entitled to keep the fruits of his labor. It is these freedoms and protections that give so tremendous an incentive to production.

The underdeveloped areas have not yet learned these principles. That is the chief reason why they have remained underdeveloped. The vice of Point Four is that it continues to protect the underdeveloped areas from this knowledge. If they had to go to foreign private investors to borrow the capital they need, these investors would not lend until they were assured of certain minimum reforms (1) guarantees to private property against nationalization, confiscation, or excessive taxes; (2) freedom to withdraw earnings or principal (which would mean the dismantling of exchange control); (3) freedom from vexatious controls generally, such as price fixing, wage fixing, and arbitrary profit limitation. Under such conditions, foreign capital would flow into such areas and speed their development as British capital once speeded the development of the United States.

The reforms that would give most incentive to the investment of foreign capital are happily the same reforms that would give most incentive to the investment of domestic capital. But as long as India or Brazil, for example, can get handouts from the American government without making the economic reforms or giving the economic assurances that private capital would require, then the politicians of these countries need not bother to make these reforms. And so confidence and productivity are not increased. Point Four, in sum, far from speeding up the economic productivity of the world, in fact retards it.

#### FOOTNOTE ON CONFUSION

My article in the issues of June 30, entitled "Why Not Try Capitalism?", should have been and *was* entitled in my original copy *The Myth in the White Suit*. The substitution was due to one of those last-minute composing room misunderstandings that it would take too long to explain but may not be too late to mention with regret. ❁

## Our Laws Create Strikes

July 14, 1952

Settlements have a way of suddenly being made even when they seem least likely; and it is possible that, when these lines appear, the steel strike will be over. But it has not been possible, since the extraordinary decision of the Wage Stabilization Board, to settle the strike

without destroying the last pretence of a wage "line" or "ceiling." The strike can now be settled only by bringing a threat of further inflation. For the terms of settlement, even if they prove no more favorable to the strikers than those offered by the steel companies several weeks ago, will not only greatly raise the cost of producing steel; they will let loose a flood of new wage demands and new strike threats from other unions that will insist on catching up with the steelworkers. And, of course, no consistent reason will be left for refusing these demands.

The steel strike is primarily Mr. Truman's strike. If he and his board had not interfered, it probably would have been either averted or settled long ago, and on far more reasonable terms than it is possible to settle it now. But the Wage Stabilization Board not only recommended wage increases that destroyed even all its own stretchable standards of "stabilization," but it assumed authority to recommend a union shop. Then, to make it still more difficult to get a settlement, Mr. Truman's price controllers announced that they were not prepared to allow the companies to pass on in prices the increased government-awarded wage costs. This was an attempt to use price-and-wage control powers, not to stabilize, but to boost wages and to squeeze profits.

Even if Mr. Truman were belatedly to apply the injunction provisions of the Taft-Hartley Act, as Congress has explicitly requested, it is doubtful that this would settle the strike. For he has publicly declared that the Taft-Hartley procedures at this time would be "grossly unfair" and "futile"; he has denounced the companies for "conspiracy against the public interest," and he has virtually invited the unions to flout the law. Yet though Mr. Truman's course has encouraged and prolonged the steel strike, Congress cannot escape its share of responsibility. It helped to create this paralyzing nationwide strike by its own legislation over the last twenty years. It still lacks the courage to repeal or amend that legislation. It has granted the unions special immunities from the antimonopoly laws. Through the Norris-La Guardia Act it has made private injunctions against strikes all but impossible. Through the Wagner-Taft-Hartley Act, it has made it perilous or impossible for an employer to discharge strikers and hire other workers in their place. It has made the government, in effect, a union-organizing agency. And it has forced employers to recognize and bargain with industrywide unions.

In the July issue of its monthly *Survey*, the Guaranty Trust Co. of New York argues ably and temperately that: "The only solution to the problem that is in harmony with the basic American principles of free labor and free enterprise is to limit the size of

the bargaining unit. . . . It may not be necessary in all cases to confine the bargaining unit to the single-plant level, or even the single-company level, What is essential is that the bargaining unit be kept small enough to make it possible for a dispute to be fought out . . . without threatening such serious effects as to necessitate or furnish a pretext for governmental intervention in the public interest."

The *Survey* seems to imply that industrywide bargaining should be *illegalized*. This, in my opinion, is a drastic step that should at least be deferred. What Congress should do immediately, however, is to stop *forcing* employers to recognize and deal with industrywide unions, to stop legally *imposing* industrywide unions on employers. For the industrywide unions, as Leo Wolman has summarized it, "can today paralyze the economic life of the country or dictate the terms on which they refrain from doing so." And the industrywide unions are the creatures of present Federal law. ❖

## GOP Platform Economics

July 21, 1952

The purpose of the typical party platform is to attract as many and to alienate as few votes as possible. It must try to reconcile or compromise conflicting views within the party. It seeks to find verbal formulas that can mean all things to all men. For these reasons nearly all platforms are full of glittering but vague generalities, and often embody outright contradictions. This year's Republican platform contains its share.

The platform favors "reduction of expenditures." But it also asks for more aid for veterans, "amendment of the Old Age and Survivors' Insurance System to provide coverage for those justly entitled to it but who are now excluded," and aid to farmers apparently as lavish as any being provided by the Democrats.

The platform deplores the encroachments of Federal jurisdiction. But it believes in "enacting Federal legislation to further just and equitable treatment in the area of discriminatory employment practices."

The platform favors "the expansion of mutually advantageous world trade." It promises to "press for the elimination of discriminatory practices against our exports." It supports our reciprocal-trade agreements "on a basis of true reciprocity." But then it promises to "safeguard our domestic enterprises and the payrolls of our workers against unfair import competition." It does not tell us what kind of import competition is "unfair." One gathers, however, that we may not extend the same

cordial welcome to imports from other countries as we expect them to extend toward ours.

Contradictory virtues, too, are claimed for the Taft-Hartley Act. We are told that it guarantees "the right to a job without first joining a union." But we are also told that it guarantees "the right to establish 'union-shop' contracts by agreement with management." Now, obviously, wherever the majority of a union or a group of union leaders establishes a union-shop contract, the individual loses his right to hold a job without joining a union.

The platform is ambiguous on important points. It promises, for example, to "remove . . . injurious price and wage controls." Each reader must decide for himself whether this means that the Republican Party will remove all price and wage controls because such controls are necessarily injurious, or whether it will remove only those *particular* price and wage controls that in its opinion happen to be injurious.

The platform is eloquent in defense of economy and free enterprise. Yet it favors "a farm program aimed at full parity prices for all farm products . . . commodity loans on all nonperishable products . . . expanded soil conservation . . . [and] further development of rural electrification." Only the Brannan plan could top this for expensiveness.

Yet when all this has been said, the Republican platform, for those who believe in economy and free enterprise, will probably prove incomparably preferable to the Democratic platform; just as the Republican record will probably prove incomparably preferable in this respect either to the past or the prospective Democratic record. On every economic ground this is a far better Republican platform than that of 1948. The monetary policies are courageous and in themselves sound, and would more than justify a change of Administrations:

"1—A Federal Reserve System exercising its functions in the money and credit system without pressure for political purposes from the Treasury or the White House.

"2—To restore a domestic economy, and to use our influence for a world economy, of such stability as will permit the realization of our aim of a dollar on a fully convertible gold basis."

I am sorry that space does not permit me to point out more fully how much courage, understanding, and good sense are embodied in each of those two declarations. Faithful adherence to them could bring an immediate end to the threat of further inflation.



The platform neatly sums up the New Deal tendency: "For 20 years the Administration has praised free enterprise while actually wrecking it." ❁

## Price Control by Default

July 28, 1952

Price control today makes no economic sense; and yet it has been renewed. It is not a cure for inflation; and yet it has been retained. It is not a minor nuisance. It distorts and curtails production. It is a dangerous political weapon in the hands of the regime in power—a weapon by which it seeks to reward its friends and punish its enemies. Its prolonged retention imperils the free-enterprise system.

There was no irresistible majority demand behind the continuance of price control. The House, in fact (as shown by the vote on the Talle amendment), wanted to discontinue most of it. Both the House and the Senate passed provisions that rejected the dangerously harmful controls imposed by the International Materials Conference. Yet the Truman-dominated conference committee succeeded in throwing out all these provisions. The House, after less than an hour's debate, meekly accepted the committee's reversal. So we still have a price-control law nearly as bad as the one that expired.

The renewal of the law has already done great harm. It has been responsible, for example, for further prolonging the steel strike. Many of the steel companies were willing from the start to accept even the record wage increase awarded by the Wage Stabilization Board if they were permitted to pass on the increased labor costs by a corresponding increase in prices. But up to a late hour Price Administrator Arnall was still standing in the way of a settlement by refusing to grant such an increase.

Yet if price control makes no sense economically, and if even the political demand for it is so doubtful on net balance that Congress did not want to renew it, how did Mr. Truman succeed in getting it renewed? The answer is that while there has been some public awakening to the futility and folly of price control, this awakening has not yet gone far enough. Congress renewed price control because it was afraid that the Administration would otherwise try to pin the blame on it for any further price rise. And yet Congress failed to put into the law the only provisions that would have prevented such a price rise. The real cause of inflation is the increase in money and bank credit. Congress could have prevented the Administration from inflating

further simply by making the Federal Reserve Board independent of Treasury or Presidential dictation; by restoring at least the previous 35 and 40 percent required reserve ratios of the Federal Reserve Banks, and by depriving the Federal Reserve authorities themselves of the power to inflate further.

The statement issued by Mr. Truman when he signed the new controls law betrayed the contradictions in his case. "At a time," he wrote, "when our defense production is still expanding and necessarily contributing to inflationary pressures, the Congress has weakened price controls." But defense production does not *necessarily* contribute to inflation at all. It does so only to the extent that it is not financed either out of increased taxation, or out of reductions in previous nondefense expenditures. It does so, in short, only to the extent that it is financed by deficits, themselves financed by increasing the money supply.

Congress, the President complained, "has virtually canceled selective credit controls." But *selective* credit controls are the last refuge of the inflationist and the controlist. They encourage bureaucratic favoritism and discrimination between different firms, industries, and group interests. The only honest, workable, and free-enterprise way to stop inflation is through *overall* credit controls. In fact, it is merely necessary for the Federal authorities themselves to stop inflating—to stop monetizing government bonds, to stop holding down interest rates to inflation-stimulating levels.

But the Administration wishes to continue to inflate, by increasing the money supply, while pretending to "fight" inflation with price control. And Congress, by its new law, has enabled it to do precisely this. What Mr. Truman was really struggling for was not a cure for inflation but a campaign issue. And Congress, because of its own confusion, gave it to him. ❁

## 'You Never Had It So Good'

August 4, 1952

A couple of weeks ago I risked here the prediction that for those who believe in economy and free enterprise, the Republican platform would probably prove incomparably preferable to the Democratic platform. The prophecy proved to be quite safe.

The Democratic platform opens with the same theme song it has sung for twenty years. It is still fighting the campaign of 1932, still blaming the world depression on Herbert Hoover, still claiming credit for every advance in position or production that anybody



has made in the last twenty years through his own efforts.

In its offers to hand out the taxpayer's money to every imaginable pressure group, the Democratic platform reaches new heights of vicarious generosity. It demands bigger unemployment benefits, bigger public-assistance programs, bigger old-age benefits, more Federal spending for medical care, school lunches, housing of every kind, including that for "middle-income families," and more handouts to veterans. In fact, America, out of the fullness of your, the taxpayer's, bottomless income, is going to pour out money to "lift the living standards" of practically everybody on earth, including specifically the Arabs and "the people of the Middle East." Presumably a Democratic Administration will give Iran still more money as a suitable reward for seizing oil wells and refineries vital to the security of the Atlantic Pact nations and for stirring up anti-Americanism.

The farm handout program deserves special mention. The platform specifically "applauds" Congress's recent action "in setting aside the 'sliding scale' for price support through 1954" and endorses a "mandatory price support program at not less than 90 percent of parity." Even leading farm organizations have shrunk from such Federal lavishness, fearing its ultimate consequences. But in the Democratic platform this is only a beginning. Undeterred by the potato fiasco, the platform demands the extension of price supports "to the producers of perishable commodities, which account for three-fourths of all farm income." Everybody is going to subsidize everybody else.

In flagrant contradiction to all this, the platform "solemnly" pledges "the preservation of the financial strength of the government." It believes "in keeping government expenditures to the lowest practicable level."

Doubtless the money for all these spending schemes is to come out of some invisible fourth dimension. We cannot expect any serious discussion of the inflation problem in such a platform, and we get none. There is no recognition of the fact that inflation is caused primarily and overwhelmingly by the increase in money and bank credit, and there is no proposal to check this increase. Even the endorsement of price control blandly cancels itself out: "We pledge continuance of workable controls so long as the emergency requires them . . . and their removal as quickly as economic conditions allow."

The platform's attack on the Taft-Hartley Act, however, is outstanding for its lack of candor and disregard of facts. It calls for the "repeal" of the Taft-Hartley Act. Nothing, however, would be more calculated to appall the New Deal Democrats and the labor leaders who

direct them than the simple repeal of the Taft-Hartley Act. What they want (though they do not admit it) is the restoration of the completely one-sided Wagner Act. In their absurd charges, the drafters of the Democratic platform seem to have forgotten that the Taft-Hartley law was passed in 1947 not merely by a majority of Republicans but by a majority of Democrats in both houses of Congress.

For the platform to say that the Taft-Hartley Act "has been proved to be inadequate, unworkable, and unfair" is a piece of brazen impudence. In the crippling 54-day steel strike the President did not even try to apply or to work the injunction provisions of the law. Instead he allowed the strike to run until he and Phil Murray had in effect succeeded in forcing the union terms on industry. ❁

## In the Wake of the Strike

August 11, 1952

The steel strike was ostensibly directed against the steel companies. But the loss of profit by the companies, and the even greater loss of tax revenues by the government, are now among the less important considerations. What comes foremost is the loss that the strike caused to the country. This has been estimated at some \$4,000,000,000. In material terms, it came to 17,000,000 to 20,000,000 tons of steel-equivalent, as Henry H. Fowler, Defense Production Administrator, has pointed out, to "more than the total capacity of Great Britain . . . in a full year's operation."

The most telling summary of the loss was made by Defense Secretary Robert A. Lovett: "No enemy nation could have so crippled our production as has this work stoppage. No form of bombing could have taken out of production in one day 380 steel plants and kept them out nearly two months. The weird and tragic thing is that we've done this to ourselves."

Who gained by the strike? The steelworkers? They lost collectively more than \$350,000,000 in wages—an average of about \$625 each. Even with their new increase, they will have to work a year to a year and a half before they have made up the loss that their self-elected idleness caused them.

Was the strike justified? Necessary? Before it started, the steelworkers were getting \$1.88 an hour. This was already 24 cents more than the average wages being paid in all manufacturing industries. As compared with June 1950, at the outbreak of the Korean

war, steel wages had risen 12½ percent compared with an increase of 11 percent in the cost-of-living index. On any plausible “stabilization” formula, therefore, or on any concept of “equity” as compared with other wages, there was no ground for any increase in steel wages. Yet the companies were forced to submit the case to Mr. Truman’s Wage Stabilization Board, which recommended an increase of some 26.5 cents an hour, including “fringe” benefits, and called for compulsory unionism in addition.

Immediately all the pressure and propaganda of the Federal government were thrown into forcing the companies to make this settlement. And the companies, in the end, had to grant an increase equivalent to 21.4 cents an hour, as well as compulsory unionism (with a few escape clauses of negligible practical importance).

What may prove to be even greater than the cost of the strike is the cost of the settlement. It destroyed every pretense that the Administration is trying to hold down wages. It proved once again that there is no wage ceiling that a determined union leader cannot tear through at will. There will now be a flood of demands from other union leaders to catch up with or surpass the steelworkers. Once more the government has bought off one set of wage demands at the cost of provoking a hundred others.

From the first the government was not an impartial arbiter but a party to the dispute. Mr. Truman went on the air to take the side of the unions. He refused to carry out the legal provisions enacted by Congress for precisely such an emergency. He seized the companies in defiance of the Constitution. He prolonged the strike by trying to force a wage increase while refusing a corresponding price increase. When his lieutenants at last granted the price increase, they bitterly threw the full blame for the strike on to the companies struck against. Roger L. Putnam, Economic Stabilization Administrator, accused them of holding “a loaded gun” to the government’s head. He neglected to mention the really loaded guns that Philip Murray and Mr. Truman had held to the companies’ heads.

The leading moral of all this is to get the government out of wage arbitration, and to deprive it of wage-fixing and price-fixing powers. The result of government intervention has been to try to boost wages while squeezing profits; to build up industrywide unions; to encourage and prolong strikes and make their impact more deadly. The ultimate result of such a policy must be disastrous to a free economy. ❁

## ‘Isolating’ Steel Prices

August 18, 1952

Mr. Truman’s Wage “Stabilization” Board recommended a thumping increase in steel wages that tore through every “ceiling” that the board itself had set. Before this increase was awarded, hourly steel wages, since the outbreak of war in Korea, had already gone up more than the cost of living. They were already 14½ percent higher than the average hourly wage paid in all manufacturing industry. Mr. Truman nevertheless did everything possible, including resort to unconstitutional seizure of the steel industry, to force the WSB wage increase on the companies. He tried to do this without granting a compensating price increase. Finally he found that in order to get Philip Murray an additional 11 percent increase in steel wages he had to allow a 5 percent increase in steel prices.

The next step was for Mr. Truman’s price controllers to start bitterly denouncing the steel companies for the 5 percent steel-price increase. They studiously avoided any mention of the 11-percent wage increase, forced on the companies, that had made the price increase necessary.

And then the next step was for the price controllers to announce that they were going to “isolate” the steel-price increase from any inflationary effect by forcing steel fabricators and distributors to “absorb” the whole of it.

Now this sort of talk is as dangerous as it is foolish. It begins by ignoring the fact that the steel-price increase was forced by the steel-wage increase. And even a price controller must know that it is politically impossible to grant a thumping wage increase to one group, already being paid above the average, while denying a similar wage increase to other groups. By its decision on steel wages the Administration has left itself no consistent or plausible ground for denying similar wage increases around the circle.

It is politically possible, of course, at least for a short time, to “isolate” a *price* increase by forcing special groups of fabricators to absorb it. But we cannot escape the long-run economic effects of such a policy. These groups of fabricators will have their costs raised without having their prices raised. Their profit margins will be forced down as compared with profit margins of producers in other lines. This means that production by these steel fabricators—and especially any expansion of their productive capacity, and new capital investment in their industries—will be discouraged and reduced. Yet the steel fabricators represent the very kinds of production—of guns, shells, tanks, engines, ships—that the

government professes to be most eager to increase. It need hardly be pointed out that this cost-absorption policy is contrary to any principle of equity. It is an attempt to force a special set of producers to assume the entire burden of a cost increase created by a government decision. A's profit margin and income are to be cut in order to relieve B. This sets up political discrimination as a policy. Nor would matters be helped by an attempt to penalize all producers in order to help consumers. In the long run, it should be obvious, it can never help consumers to hurt producers. To hurt producers is to hurt production, and to leave less of everything for everybody.

The bureaucrats' belief that they can "isolate" a particular price rise once more reflects their utter lack of understanding of our marvelous productive system. All prices, wages, and costs are interrelated. The change in a single important price sends repercussions through the whole price network and alters the whole balance of production among different commodities.

It remains to be pointed out once more, finally, that price-fixing is a fraudulent remedy for inflation, and that the Administration's "fight" against inflation is a sham battle. The cause of inflation is the increase in money and bank credit. The Administration is still busy trying to increase money and bank credit. Its new strategy is what its price fixers are calling "controlled escalation." As even the friendly London *Economist* has put it, Mr. Truman "is taking every precaution to insure that the inflation continues through the election period." ❀

## Is Inflation a Blessing?

August 25, 1952

Sumner H. Slichter is professor of economics at Harvard and enjoys in some circles a reputation as a first-rate economist and even as an eminent "conservative." He has done some instructive work; but when he writes on the subject of money and inflation, as he has taken to doing frequently of late, the result is deplorable. His article in the August issue of *Harper's*, "How Bad Is Inflation?" is an epitome of all the shopworn fallacies that have been put forward as apologies for inflation in the last two centuries.

He begins by dismissing the conclusions on inflation by the American Assembly, a group of distinguished economists, as "uncritical and almost hysterical." The assembly concluded that "inflation is a continuous and serious threat to the stability of the American economy

and to the security of the entire Western world." This judgment was not hysterical, but restrained.

It is Slichter who is appallingly uncritical. He not only thinks that it is easy for a government to plan and control "a slow rise in prices"; he actually believes that an "extreme" inflation "is not easily started." It would be interesting to learn what his definition is of an "extreme" inflation, and what his concept is of difficulty. Germany inflated until its mark fell to one-trillionth of its previous value. Nationalist China recently inflated until the yuan reached 425,000,000 to the dollar. In Great Britain prices are three times as high as they were before the second world war; in the Argentine (with no "war" excuse) prices are five to eight times as high; in France, more than 25 times as high; in Italy, more than 50 times as high. None of these countries found it at all difficult to get its inflation going, but most of them are finding it politically impossible to stop.

Slichter's argument throughout is based on assumptions that are neither proved nor warranted. One of these is that a rising price level is necessary for prosperity. This is refuted by a wealth of historical experience. The great American boom from 1925 to 1929, for example, occurred in spite of a *falling* price level. And Slichter does not seem to know that depressions are caused chiefly by the collapse of previous inflations.

Nor does Slichter seem to understand how inflation temporarily works its magic. It does so only as long as prices run ahead of costs (mainly wages). Then the prospective restoration or increase of profit margins may lead to an increase in production and employment. But the jig is up once labor gets on to the game, and wages and other costs begin to rise faster than prices. The apostles of permanent inflation ("continuous slow" inflation) are those who believe that labor can be permanently fooled.

Slichter does not explain in his article by exactly what process a "slow" permanent rise in prices—say 2 or 3 percent a year—could be produced. He does not understand why no nation has yet succeeded in keeping an inflation, once started, under control. He forgets that you can't afford to tell people in advance that you are *planning* to cheat them. A government can't *plan* a "gradual" increase in prices, because if people know that prices will be 3 percent higher, say, next year, they will bid prices up that much right away. If creditors *know* that the purchasing power of the money they are asked to lend today is going to depreciate 3 percent within a year, they will add 3 percent to whatever interest rate they would otherwise demand; so that instead of lending at 5 percent, say, they will ask 8.



Most fantastic of all, Slichter advocates a continuous inflation to *combat* Communism. I refer him to the late Lord Keynes, who wrote a generation ago: "Lenin is said to have declared that the best way to destroy the capitalist system was to debauch the currency. Lenin was certainly right. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose."

Amen. And Slichter, alas, is not that one man. ☸

## 'Planning' for 1975

September 1, 1952

Several excellent comments—by *The Wall Street Journal*, by Lawrence Fertig in *The World-Telegram & Sun*, and by the Guaranty Trust Co. of New York in its August *Survey*—have already appeared on the massive five-volume report put out by the President's Materials Policy Commission. But a good deal more than this will need to be done both by individuals and groups if we are to have any adequate analysis of what *Fortune* lyrically hails as "one of the greatest, most readable government documents of the century," and if we are to have any chance of heading off a new network of government controls.

The technique of this report is familiar. It begins by fearing an alleged "crisis"; it ends by concluding that only more government power, more government controls, more government bureaucrats, can save us from it.

The crisis this time is a "deficit" of raw materials. It seems that in 1900 this country produced 15 percent more than it consumed of raw materials other than foods and gold; that by 1950 this surplus had been supplanted by a 9 percent "deficit," and that without more government intervention this "deficit" may reach 20 percent by 1975.

Now even if this guess were right it wouldn't necessarily be alarming. England built itself up to the greatest industrial nation in the world in the nineteenth century by importing raw materials to export finished goods. In a peaceful world of free trade we could play a similar role.

But there is no good reason for supposing the commission's guesses to be right. They are based on dubious deductions from a set of arbitrary assumptions. Why should we take seriously, for example, the guess that by 1975 we will need only 18 percent more tin a year but 1,845 percent more magnesium? Anyone would be lucky today to make a good guess concerning the 1975 consumption of any one item. It is sheer presumption

to try to guess with an air of authority the relative consumption by 1975 of thousands of different items. Who can foresee today the vast changes that may be brought about by new discoveries, conversions, and inventions? Yet a government that has persistently failed to guess even its own fiscal deficit a year ahead has no qualms about guessing every raw-material deficit twenty-three years ahead.

The report undertakes to rescue us by more of the same kind of government interventions that have already become depressingly familiar. It proposes to manipulate prices, production, and exports; to establish quotas, floor and ceiling prices on the model of the International Wheat Agreement; and to create "buffer stocks" to be bought and sold by international authority to offset free fluctuations in supply and demand.

Do government commissions ever learn anything from anything? Have they learned nothing whatever from a hundred dismal and disastrous failures of the past—from the British rubber restrictions scheme, the British African peanuts scheme, the Brazilian coffee "valorization," our own potato controls, pig controls, cotton restriction, and "ever-normal granary" schemes? Must the world plunge into ever more grandiose international cartels, from the wheat pact to the Schuman plan to this latest proposal?

All these control schemes are the direct result of lack of faith in, and lack of understanding of, the free market. All this recent nonsense about each country's getting its "just" share of raw materials can only result in endless international bickering. Price controls, combined with "allocations" of raw materials to each country, can only unbalance and distort world supply, increase consumptive wastes, result in allocations to individual firms *within* countries, and so undermine competition and the growth or shrinkage of individual firms in relation to their relative efficiency. All these schemes can only end by further "politicalizing" every economic transaction—by socializing, regimenting, and eventually totalitarianizing our economy at home and throughout the so-called "free" world. ☸

## The Case for Free Markets

September 8, 1952

The economic problems of the British and ourselves are more alike than is usually supposed. Both of us are suffering from the monetary inflation created by our respective governments' own policies; and both of us are suffering even more from the government controls imposed ostensibly to protect us from the consequences



of this inflation. The difference between our respective problems is chiefly one of degree, not of kind.

This becomes clearer when we read an admirable article like that of Lord Balfour of Burleigh in the July issue of *Lloyds Bank Review* of London. His arguments are directed against the controls in Britain, but they apply with equal force against the controls here.

Lord Balfour begins by explaining the “immense superiority” of a free price system. “The price mechanism . . . and direct or physical controls . . . are the two fundamentally different methods of adjusting the demand for any good to the available supply. Under the price mechanism, supply and demand are brought into harmony by the movement of prices; the allocation of the available resources is determined by the operation of market forces. . . . [This] is the kind of situation we took for granted before the war, a situation in which every single consumer in the country could walk into any shop anywhere and buy (up to the limit of his money income, naturally) whatever he wanted. . . . In those days there were no such things as ‘shortages,’ not because physical supplies were necessarily any greater but because prices were uncontrolled and so brought demand and supply into balance. Nowadays, of course, the very expression ‘uncontrolled’ prices suggests exorbitant prices. In reality, as we all know, the free, uncontrolled prices of prewar days were both low and stable by comparison with anything that has happened since. The situation, now so familiar, in which any price that is free to move tends to shoot upwards, is a product of inflation.”

When rationing and allocation take the place of free prices, the decisions are taken, not by the consumers themselves, but by bureaucrats who say in effect: “We know best what you want.” Consistently applied, as Balfour points out, the allocation system leads to direction of labor—a gross violation of freedom. “What do we value most in our way of life? Surely our liberty. Of all freedoms, with perhaps the single exception of freedom to choose our job, none contributes more to our real liberty than the freedom to spend our money as we will and to give free rein to our individual choices and desires.”

Balfour goes on to show that “there cannot really be any dispute about the superior *efficiency* of a properly working price system. . . . Rationing and controls are merely methods of *organizing* scarcity; the price system automatically works towards *overcoming* scarcity. If a commodity is in short supply, a rise in its price does not merely reduce demand but will also tend to stimulate an increase in its supply. In this, the price system stands in direct contrast with rationing and controls, which tend

to make it less profitable, or less attractive in other ways, to engage in essential production than to produce the inessentials which are left uncontrolled.”

Balfour’s final step is to show how artificially low interest rates create inflation, and how effective and even “selective” a weapon is an increase in the Bank of England rate. It can not only halt inflation, but it can help to balance trade and to direct production into the desired channels.

It is a pity that so much clearheadedness on the part of the chairman of Lloyds Bank should be marred by a blind spot. He cites exchange control, for example (one of the most vicious controls of all), as an *exception*, arguing that it “cannot be abandoned until the balance of payments is put right.” But if he had followed the logic of the rest of his article he would have recognized that the unbalance in Britain’s payments is *caused* by exchange control. Only foreign-exchange rates freed from price control will bring “supply and demand into balance.” ❁

## Adlai in Wonderland

September 15, 1952

Mr. Truman has never been one to let a mere fact get in the way of his campaign oratory. “It was the Republicans,” he said on Labor Day, who “put across the Taft-Hartley Act in 1947.” This is unjust to his Democratic colleagues. The Taft-Hartley Act was passed by a majority of Democrats in both houses of Congress and even passed over Mr. Truman’s veto by a majority of Democrats in the House. The President has been insisting that Taft-Hartley is a slave-labor act and a union-busting act; and yet, after five years of that act, he inconsistently boasted on Labor Day that union membership had grown from less than 3,000,000 in 1933 to a record 16,000,000 now.

Candidate Stevenson was more subtle—but considerably more confusing. He began his Labor Day speech by telling the union leaders that he is no captive of theirs, that “I intend to do exactly what I think right”—but then it turned out, by miraculous coincidence, that what he thought right was exactly what the union leaders were insisting on. What he thought right did not quite coincide, however, with what he thought right just before his nomination. Then he wanted only “modification” of Taft-Hartley; now he calls for outright repeal.

He wants the act repealed, as far as I can make out, so that it can be passed all over again under a different name. Most of his “five general principles” and other ideas are already embodied in the existing Taft-Hartley

Act; wherever they are not, it is Stevenson who is wrong. He piously declares that “we cannot tolerate shutdowns which threaten our national safety.” But then he wants to deprive even the government of the right to request an injunction—the only weapon that the Taft-Hartley law provides for at least postponing a nationwide strike that threatens our safety. Even Mr. Truman, in vetoing the Case bill on June 11, 1946, told Congress: “Injunctions requested by the government itself and designed to restrain strikes against the government in . . . a condition of national emergency are, to my mind, an essential element of government authority.”

Though he is supposed to be a lawyer, Stevenson thinks that Congress passed the Norris-La Guardia Act in 1932 “to prohibit the labor injunction.” This is untrue. The Norris-La Guardia Act, although it narrowly restricts the conditions, sanctions injunctions against union “fraud or violence.”

What remedy, then, does Stevenson propose in place of the injunction? He won’t say. “I have no miracle-drug solution for this problem.” In short, he has no solution at all. But what he actually proposes is that the President be given in advance his “choice” of practically unlimited powers against *employers*. Among these he specifies all the powers that failed so disastrously in the steel strike when Mr. Truman used them legally or by usurpation—government “recommendation of settlement terms”; “arbitration” (presumably compulsory), and “seizure” of companies that don’t accept a union-dominated government’s “settlement terms.” And then Stevenson blandly describes this law—which would allow the President to seize the employer’s property and impose settlement terms—as a law that would “keep these cases out of the White House” and “leave the obligation to settle these disputes where it belongs—and that’s with the parties!” This makes the arguments in *Alice in Wonderland* sound comparatively sane.

The real defects and contradictions in our present labor laws the Democratic candidate did not even discuss. The employer is prohibited from firing a man for joining a union, but he is permitted, encouraged, and even forced to fire a man for not joining a union. This one-sided denial of individual rights to workers Stevenson passes over in complete silence. And he passes over in complete silence, also, the notorious fact that the reason industrywide unions have the power “to stop the national economy” unless their terms are met is precisely because the Wagner-Taft-Hartley Act legally *compels* the employer to recognize and bargain with such unions. ❁

## The Bribe to the Farmer

September 22, 1952

Once a government undertakes to subsidize or guaranty a favored group of producers against the competition and vicissitudes of a free market, it creates a permanent vested interest in the continuance and constant enlargement of its subsidy or guaranty.

The world upheavals and bad government policies following the first world war led to great distress among American farmers. There was much talk about restoring “fair” prices for the farmer’s products. A strange idea was born. This was that the particular relationship between agricultural prices and other prices which prevailed from 1909 to 1914 represented some sort of mystical “parity,” and that the aim of government policy should be to restore it. Actually those five years were one of the most favorable periods to agriculture, so far as relative prices were concerned, in our entire history.

But even if this had not been so, the idea that there was some mystical “parity” ratio between agricultural and industrial prices, which ought to be permanently maintained, was economic claptrap. If there had been any disinterested logic behind the idea, it would have been applied all around the circle. An attempt would have been made to preserve indefinitely the particular price relationship that existed from 1909 to 1914 between every commodity and every other—no matter what profound changes occurred daily or over the years in supply and demand, in costs or methods of production, or in consumers’ wants.

Fortunately, no such preposterous proposal was ever made. Yet “parity” prices for farm products are still demanded by politicians, and the notion of “parity” prices is still treated with solemn respect.

And the government handouts keep growing. Today, when the farmers are enjoying what would have been regarded in 1934 as unbelievable incomes and prosperity, they are getting not smaller, but far bigger handouts than they were then. Strict comparisons are difficult because of the caprices of government accounting. But in 1934, when farm income totaled \$6,117,000,000, government payments to farmers amounted to \$250,000,000. In the fiscal year 1952, when farm income had soared to \$33,573,000,000, government payments for farm programs had gone up to \$1,042,000,000. For the fiscal year to end next June 30 they are planned at \$1,804,000,000.

In its September letter the National City Bank of New York presents an instructive history of farm price support. “What started out as an emergency program to

cushion the collapse of farm prices during the depression," it points out, "has been gradually transformed into a permanent program of price supports with a constant upward bias." Even farm organizations have been unsuccessfully urging Congress to show restraint.

But the two major parties are now competing recklessly with each other in bidding for the farmer's vote with the taxpayer's money. The Democratic platform wants "a mandatory price support program at not less than 90 percent of parity." The Republican platform calls for "a farm program aimed at full parity prices for all farm products in the market place." Governor Stevenson first piously quotes Jefferson's fine motto: "Equal rights for all; special privileges for none," then insists in special handouts to the farmer, and even argues that boosting the prices that the farmer gets doesn't boost the food prices that the housewife pays. General Eisenhower, not to be outdone, not only stands behind the present price supports at 90 percent of parity, but adds: "And a fair share is not merely 90 percent of parity—it is full parity."

Where does all this leave the lip-service in favor of government economy? When are we going to learn the economic absurdity of trying to subsidize everybody at the expense of everybody else? And when will the candidates of both parties realize that when they try to bribe each special group in turn, out of the public purse, they are participating in the debasement and eventual disintegration of our democracy itself? ☸

## Are You Better Off?

September 29, 1952

The Democratic theme song in the present election is "Don't Let Them Take It Away." The implication is that every increase in wealth, income, or production achieved by any American in the last twenty years has been due, not to his own efforts, but to New Deal-Fair Deal paternalism.

This is, of course, nonsense. As Macaulay pointed out in his *History of England* more than a century ago: "No ordinary misfortune, no ordinary misgovernment, will do so much to make a nation wretched as the constant progress of physical knowledge and the constant effort of every man to better himself will do to make a nation prosperous. It has often been found that profuse expenditure, heavy taxation, absurd commercial restrictions, corrupt tribunals, disastrous wars, seditions, persecutions, conflagrations, inundations, have not been able to destroy capital so fast as the exertions of private citizens have been able to create it."

Even if it could be proved, in short, that the American people have made great advances in wealth, income, and productivity in the last twenty years, it would not follow that they had done so *because* of the New Deal and Fair Deal. This may have been merely a continuation of the rate of progress shown throughout our history. And it may have been made in *spite* of mischievous governmental policies.

But are the American people in fact better off today than they were, say, in 1939? Herbert J. Miller, executive director of the Tax Foundation, has made an impressive analysis to challenge the claim. Some of his results were summarized in last week's *Newsweek*, but the question warrants further study.

The first thing Miller had to do with the statistics so glibly cited by Administration apologists was to adjust them to realities. Mere dollar comparisons are utterly misleading. A married man with two children, for instance, whose net income before taxes was \$4,000 in 1939, would have to make \$9,139 in 1952 to reach equivalent buying power after taxes and inflation. After reducing the inflated figures to a per capita basis and to a dollar of constant purchasing power, Miller comes up with some surprising results:

1—Per capita personal income, after taxes and in 1939 dollars, rose from \$536 in 1939 to \$760 in 1951, a 42 percent increase. Yet all the increase occurred between 1939 and 1944. There was a *decrease*, in fact, of 2 percent from 1944 to 1951.

2—While total individual net worth (assets minus debts) was 9.2 percent greater in 1951 than in 1939 (in 1939 dollars), it was 7.4 percent *less* per capita, 12.5 percent less per family, and 24.7 percent less per worker.

3—Individuals were 54 percent further in debt in 1951 than in 1939 even when debt is expressed in dollars of constant purchasing power.

4—There was a per capita increase in national wealth (excluding military assets) of about 9 percent in 1951 over 1939. But there was a *decline* of 4 percent in 1951 compared with 1929. (From \$3,501 in 1929 to \$3,356 in 1951, in 1929 dollars.)

Miller even understates the evil effects of inflation. It "has not been an unmixed blessing to put it mildly." But inflation always affects different groups differently. And it can in fact be mathematically demonstrated that, given a state of reasonably full employment, at least about half the population must lose more from a further rise in the cost of living than it gains from a further rise in its own prices or income.

Administration spokesmen, when they forget that their theme is "You never had it so good," inadvertently admit this. Said the Secretary of Labor in a bulletin of



his department last December: "Nearly 45 percent of the wage earners of the United States failed to keep pace with the 10.1 percent rise in the cost of living from January 1950 to June 1951." And it was just last month that the Bureau of Labor Statistics thoughtlessly reported the rising cost of living has forced the average American city family to spend \$400 more than its income after personal taxes (see page 73). ❀

## And Now, the Double-Deal?

October 6, 1952

"Doublethink," according to the late George Orwell, who coined the word, means "the power of holding two contradictory beliefs in one's mind simultaneously, and accepting both of them." It seems to me that "double-talk," now used with a vague range of meanings, would be most useful if it were employed only as the strict parallel of "doublethink"—to mean saying two contradictory things at the same time, and professing to believe both.

Doubletalk and doublethink are certainly not new in politics, but Governor Stevenson seems to have raised them to a systematic art. He is either as undecided as Hamlet, or emphatically in favor of both alternatives, like the impetuous young man who jumped on his horse and rode off furiously in every direction.

In his Labor Day speech, as I pointed out here in the *Newsweek* of Sept. 15, the governor at the same time proposed (1) government "recommendation of [strike] settlement terms," "arbitration," and "seizure" of the companies that hesitate to accept the government's terms, and declared (2) that such governmental interference would "keep these cases out of the White House" and leave the settlement of labor disputes "where it belongs—and that's with the parties."

In his speech in Baltimore on inflation Stevenson was simultaneously for huge spending and drastic economy—and got rousing applause for both views. In the same speech he was simultaneously for "a free economy . . . free men . . . free markets," and "if it has to come, tighter wage controls as well as tighter price controls."

One trouble is that Stevenson would rather fondle a phrase than wrestle with a fact. He prefers the sound to the meaning of words. He is in favor of "the government's cutting its non-essential expenditures to the bare bones of safety"—forgetting that if expenditures are "nonessential" they need not be made at all.

Many of his rhetorical pronouncements have a boomerang quality. How can he expect to impress taxpayers,

one is tempted to ask, by declaring that the government "must spend every penny as though it were a \$5 bill," when the Truman government is already spending \$5 bills as though they were pennies?

But the basic reason why Stevenson cannot talk realistically about inflation lies beyond his own limitations as a thinker and as an economist. He cannot tell the truth about inflation without, like General Eisenhower, putting the responsibility for it squarely where it belongs—on the spending and "cheap money" policies of the Truman Administration. Stevenson's phrase about \$5 bills was unfortunate because it reminds us that it is a literal fact, and not a joke, that the Truman Administration this year is spending more than \$5 for every quarter spent by President Hoover in 1930. The \$80,000,000,000 we are spending this year is twenty-seven times as much as we spent in 1929. And Stevenson has to pretend that all this *has* to be spent, and that if the government is now spending \$53,000,000,000 for defense, for example, it must be buying us \$53,000,000,000 of defense and not, say, only \$20,000,000,000 worth.

Stevenson assumes that defense expenditures necessarily raise the average level of prices. But of course they would not do so if the government took just as much away from civilian income in added taxes as it used for added defense expenditures, and if it did not print more money.

It is the increase in the money supply, brought about by governmental policy, that is the basic cause of inflation. The money supply has been increased from \$64,000,000,000 at the end of 1939 to \$193,000,000,000 today. This is not even mentioned by Stevenson. Nor does he tell us that the Federal Reserve is once more buying government securities and adding to inflation. Instead, like Mr. Truman, he ignores all this, and comes out for the fraudulent remedy of price control "until prices stop going up"—in other words, until the government itself stops pushing them up by printing more money. ❀

## Foreign Trade Follies

October 13, 1952

One gathers from the report of Aug. 22 by Ambassador William H. Draper, Jr. that the European "dollar gap" is chiefly America's fault. In this Draper reflects both European and American official opinion. The central economic problem, he thinks, is the "balance-of-payments problem of Western Europe vis-à-vis the dollar



area.” But the truth is that neither the “balance of payments problem,” the “dollar gap,” nor the “dollar shortage” would exist if it had not been *created* by unsound policies of European governments. The “problem,” the “gap,” and the “shortage” would all disappear overnight if those policies were changed.

What causes the so-called European dollar gap is the existence of monetary inflation in Europe combined with exchange control. The “unfavorable balance of payments” and the “dollar shortage” would vanish on the day the European governments stopped preventing their own citizens from buying, selling, or holding dollars or any other foreign currency in any amount they wanted and at any price they could agree upon. Europe’s so-called “cure”—exchange control—is the very disease that is choking it.

There seems to have been a tacit conspiracy among the bureaucrats of Europe and the United States in the last eight years that however we diagnose this disease, we must never call it by its real name—exchange control. And so we have been led from absurdity to absurdity. We have created, for example, the needless and futile institution called the European Payments Union, simply because European governments will not permit the only real solution—free exchange rates with full currency convertibility.

Even Draper now accepts the European myth that the balance-of-payments problem “has its roots in the huge excess of United States exports over its imports.” The explanation is completely upside down. To blame ourselves for an “excess of exports” is to blame ourselves for producing too much and for giving the excess away. It is to assume that it is somehow the duty of our citizens to buy European goods whether they want them or not. The problem is not our excess of exports; it is Europe’s excess of imports. The “balance-of-payments” problem would evaporate overnight if Europe allowed its own exporters to keep the dollars they earned or sell them for the best price they could get.

Free exchange rates would create an immense incentive, which they now lack, for European exporters. They would encourage American buyers, who could once more buy European goods at realistic prices. In the same way, either a higher dollar rate, or a halt in European inflation, would curb Europe’s present abnormal demand for American imports. If European production were freed from exchange controls, and once again rewarded in proportion to its efficiency, it would not only increase in total, but much more of it would flow into export channels.

Draper wants us to reduce our own tariffs still further, and to simplify our custom procedures. In this I

would heartily concur. But as a barrier to foreign trade, our tariff today is of merely minor and academic importance compared with the insuperable barriers raised by European governments—the rigid import quotas, special licenses, bilateralism, exchange controls and prohibitions.

While European bureaucrats have complained more and more in recent years about the barrier of the American tariff, that barrier itself has been constantly declining. Data from the Department of Commerce show that last year tariff duties amounted to less than 6 cents for every dollar’s worth of imported goods. This compares with about 15 cents during the prewar years 1936–1940, and with 27 cents for every dollar’s worth of imported goods at the turn of the century in 1901–1905. The major immediate reason for reducing our tariffs still more at this time is not economic but political. It would remove the biggest excuse Europe still offers for failure to increase its exports. And it might shame European governments at last into abandoning exchange control. ⚙

## Stalin as Classical Economist

October 20, 1952

Stalin now demands an entirely new official Communist textbook, and has turned in a 25,000-word memorandum to say exactly what it must contain.

Most of it is the usual hodgepodge of Marxist jargon, obscure dialectics, vilification of capitalism, derision of dissenters, and pure claptrap. Yet it is significant for one ingredient—the revisions that Stalin has been forced to make of Marxist, Leninist, and even of previous Stalinist doctrines in order to bring Communist theory into a more plausible relation with actual Soviet practice. These revisions tacitly concede that complete socialism is unworkable.

Stalin admits that he still doesn’t know how to bring about pure Communism and directly distribute goods to individuals in accordance with “need.” He admits that he still doesn’t know how to get rid of the much-abused capitalist price system. He specifically orders that the new textbook explain “why we . . . do not destroy production of commodities for the open market, money, trade, etc.” He admits that he still doesn’t know how collective farms can be completely socialized.

He even thinks it would be “senseless and criminal” to expropriate “small and medium-size producers in the villages and socialize their means of production.” But this is to concede that capitalism must either be right in principle, or must continue to be tolerated even in

Russia (after 35 years of absolute Communist dictatorship) at least as far as “small- and medium-size producers” are concerned. It is as if a state governor were to denounce grand larceny while contending that it is senseless and criminal to illegalize petty and medium-size larceny.

Stalin admits that he still doesn't know how or when to achieve “the Communist formula ‘from each according to his abilities, to each according to his needs’.” He professes to be operating on the formula “from each according to his abilities, to each according to his work.” He even calls this “the Socialist formula.” But modify it a bit, make it “to each what he creates,” and you have, in effect, the capitalist formula, the basic principle of free enterprise.

Finally, Stalin admits that socialism and/or Communism cannot solve the vital problem of economic calculation, and must depend on capitalism and free markets for the answer:

“Our economic executives and planners made a proposal which could not but astonish members of the Central Committee, since according to this proposal the price for a ton of grain was proposed to be almost the same as the price for a ton of cotton, and in this the price for a ton of grain was made equal to the price for a ton of baked bread. In answer to the remarks of members of the Central Committee that the price for a ton of baked bread must be higher than for a ton of grain in view of the additional expenditures for milling and baking, and that cotton in general costs much more than grain, to which also world prices for cotton and grain bear witnesses, the authors of the proposal found nothing intelligent to answer.”

Stalin, in short, cannot trust even the economic planners that he picks himself. He rejects their guess as to the relative values of cotton and grain; he knows it to be false, because it does not correspond with the verdict of the capitalist world and the capitalist price system, the verdict of supply and demand, of consumers' choice, the verdict of free markets.

“What would have happened,” he asks, “if the proposals of these comrades had received legal force? We would have ruined the cotton growers and been left without cotton.”

Stalin, in short, now knows what Truman and Bowles and DiSalle and Woods have still to learn—that bureaucratic price fixing is a farce, a fraud, and a disaster; that the economic planners are presumptuous blind men groping in the dark, and that there is no substitute for free markets.

If Stalin lives long enough, and continues his progress, he may end up as the world's leading classical

economist, and its foremost champion of laissez-faire capitalism. ❁

## The Dilemma of Foreign Aid

October 27, 1952

In a book published in 1947, *Will Dollars Save the World?*, I pointed out that intergovernmental loans or gifts were “on the horns of this dilemma. If on the one hand they are made without conditions, the funds are squandered and dissipated and fail to accomplish their purpose. . . . But if the lending [or giving] government attempts to impose conditions, its attempt causes immediate resentment. It is called ‘dollar diplomacy’ . . . or ‘interfering in the internal affairs’ of the borrowing nation. The resentment is quickly exploited by the Communists. . . . The dilemma is, in fact, inherent. It lies in the attempt of one government to bribe another into following . . . policies which that other government does not believe in sincerely enough to follow without the bribe.”

I also devoted an article to this theme in *Newsweek* of Nov. 3, 1947.

The recent tiff between the French Premier and our ambassador is simply the latest illustration of the point. Ambassador Dunn left a letter saying that the United States could not promise the \$650,000,000 in economic aid for 1953 hoped for by Premier Pinay, but only \$525,000,000. In addition, Dunn left a memorandum indicating that the French would have to increase their military budget if they wanted more U.S. aid. Whereupon Pinay hit the ceiling, let it leak to the French press that he considered the memo “inadmissible,” and won acclaim at home as “a strong man who has been willing to say no to the Americans.”

In its news columns of Oct. 10, *The New York Times* explained that the Pinay government “has been under fire of the Socialist left and the de Gaullist right for ‘subservience’ to the United States. What is more natural than that the Pinay government should try to ‘get out from under’ by stealing the fire of the opposition on both left and right by proclaiming righteous indignation in the French press over some assumed indignity.” What is more natural indeed? And what could more clearly demonstrate the futility, if not the boomerang nature, of our foreign-aid program?

Our State Department beat a quick retreat. “M. Pinay seemed to think,” it said, “that we were undertaking to say what the French budget will be, and he made it clear that that is a matter for the French to determine—and it is.” Why not carry this further? Why not point

out that the French budget is so completely a matter for the French to determine that the American taxpayer, with no say about it, has also no duty to contribute part of it? Why not point out that the way for the French Government to show its complete fiscal independence would be to stop asking the U.S. for more handouts?

The foreign giveaway program was wrong from the start. The real answer was the Atlantic Pact. But this was not in fact even proposed until well after the Marshall Plan had been launched. Under the Atlantic Pact we should undertake to defend against Russian aggression a free Europe that proves its own determination to defend itself. But by our hasty ambition to assume something we like to call "world leadership," by our overanxiety to shower monetary contributions in the absence of clear showing of need, by our panicky insistence that Europeans increase their defense budgets whether they themselves recognize their danger or not, we have done the precise opposite of what we intended.

We have encouraged Europe to relax its own efforts and to leave its salvation to us. We have increased European "neutralism." We have permitted to flourish among Europeans the fantastic notion that we need their help more than they need ours. We have given the French the impression that when they increase their armament they do it, not for self-preservation, but as a favor to the United States. We have provided fuel for Communist propaganda that we want to boss and "enslave" Europe.

Incidentally, if we stopped these lavish handouts, we would cut our budget by \$9,000,000,000 or \$10,000,000,000 annually, which is the difference between continuing inflation and halting it. ☼

## What Are We Deciding?

November 3, 1952

What is the central issue that will be decided in this election? Perhaps the best way to find the answer to this is to imagine that the election has already been held and that the outcome is already known. Suppose Governor Stevenson has won? What will the voters have said?

The answer is clear. The election of Stevenson and of another Democratic Congress will be almost universally accepted as an endorsement of the record of Harry S. Truman and a call for the continuance of the Fair Deal.

Nobody knows this better than Truman himself. It explains his desperate campaign for the Democratic

ticket. He knows that the election of General Eisenhower and a Republican Congress would be a repudiation of his regime, while the election of a Democratic successor would be a "vindication." Stevenson knows it too. Since his first feeble efforts to disassociate himself from "the mess in Washington" he has not dared to differ from Truman on a single important issue.

What will the voters have endorsed if they endorse Trumanism? They will have endorsed the most unscrupulous campaign of slander that a President has ever stooped to in our history. . . . Truman's defamation of the very man he had up until a few months ago most honored and appointed to the highest positions of trust. . . . Truman's whole record of vilification of those who have dared to differ with him, from "too many Byrds" in Congress to the Marines' "propaganda machine almost equal to Stalin's."

They will have endorsed an incredible softness to Communism, illustrated by Yalta, Teheran, and Potsdam; the attempt to force Chiang Kai-shek to take the Chinese Communists into his government; the payment of ransom to a Communist government to release captured American fliers; the tardiness in acting on Vogeler; the virtual abandonment of Oatis; the effort to dismiss the Alger Hiss case as a "red herring," the Tydings committee whitewash; Truman's statement that he liked "Old Joe" Stalin; his acquiescence in humiliations to our Ambassadors to Russia; soft now-don't-do-it-again reproofs even when the Russians deliberately shoot down American planes and men.

They will have endorsed the unbelievable vacillations and zigzags; that bungled us into a stalemate war in Korea, leaving us today with 122,000 casualties and a thin hope that the Communists may still be willing to call it a draw and let us out.

They will have endorsed the widespread corruption symbolized by deep freezers, mink coats, and the Kansas City vote frauds.

In the economic realm, if the voters return Stevenson and a Democratic Congress, they will have endorsed the most reckless spending in our history, the most burdensome and destructive taxes, and a policy of deliberate monetary inflation, especially for the campaign period. In the five and a half months ended Oct. 15, for example, money in circulation was increased \$1,157,000,000 to a new high figure of \$29,617,000,000—four times the amount outstanding in 1939. This monetary inflation has been brought about by deficit financing, government-bond support, and cheap-money policies. It means soaring living costs and a rotting dollar, which Truman pretends to offset by the futile and disruptive device of price fixing.



Pour on top of this the fantastic campaign against the Taft-Hartley Act, the misuse of the Federal government to organize and build up unions and enforce their demands, and the openly declared aim of Stevenson to deprive the government itself of the injunctive power, even against strikes that imperil the national safety.

The issue in this election, in brief, is whether Federal intervention and Federal power shall be encouraged to grow until they choke out economic and personal liberty and leave us to the mercies of an increasingly arrogant and possibly irremovable bureaucracy.

Those who want this result will vote for Governor Stevenson. Those who have misgivings about it will vote for General Eisenhower. ☸

## A Letter to Harry S. Truman

November 17, 1952

My dear Mr. President:

I want to begin by congratulating you on the fine sportsmanship and patriotic sense of responsibility which prompted you to offer the President-elect an airplane to go to Korea and to invite him to sit in with you in the formulation of the new budget and other problems of the transition period. But this won't meet the real difficulty that the transition raises, and I am taking the liberty of suggesting another course on your part that I believe will. You now have the opportunity, in fact, to set a history-making precedent that would control all your successors.

The dilemma that now confronts both you and Mr. Eisenhower is inherent in our present inflexible provisions for the transfer of power. Mere consultation, even with the best will on both sides, cannot solve it. You are now put by law in the absurd position of having to prepare a budget for a period—1953–54—in which you will be out of office and for which you cannot reasonably be held responsible. Mr. Eisenhower or his representative, on his side, will be confronted with a document as big as a telephone book, implementing scores of previous policies and made up of thousands of different items. Mr. Eisenhower could not possibly make informed decisions on these without consultation with department heads and bureau heads of his own choosing. It is unfair to ask him to take even an implied responsibility for this budget.

This is not your fault. The predicament, throughout our history, has been built into the provisions for the Presidential and Congressional succession. Prior to the passage of the Twentieth Amendment, the Presidential

succession did not take place until the March 4 after the election. I need not tell you what the appalling costs sometimes were of this four-month interregnum. It was in the four months between the election and inauguration of Lincoln that seven states seceded from the Union and set up the Confederacy. Even if Buchanan, the outgoing President, "had been a man of great strength and ability," as the historian James Truslow Adams put it, "it would have been almost impossible to strike out [on] a policy of his own, when he had only four months to serve and knew nothing of the policy of the man who would soon have to take up the reins."

The cost of the interregnum period after Franklin D. Roosevelt defeated Herbert Hoover is still fresh in the minds of those of us who lived through it. The deterioration of business confidence between the election in November 1932 and the inauguration in March 1933 was rapid and profound. Roosevelt could not act because he was not yet in office; Hoover could not lead because he lacked public support. The country paid a needless and tragic price in mounting insolvencies, bank closings, and unemployment.

An attempt to solve this problem for the future was made in the adoption of the Twentieth Amendment in 1933. Unfortunately, the amendment did not abolish the four-month interregnum; it merely reduced it to two and a half. So once more we are faced with a period of uncertainty. You now have legal power without a popular mandate, and Mr. Eisenhower now has a popular mandate without legal power. Action is frustrated. Policy must mark time.

There is one clear solution, and to you has come the opportunity to be the first President to propose it. This is to offer to resign now and turn your office over to the President-elect, either immediately or on the first day he is ready to assume it.

No further tampering with the Constitution would be necessary. You could simply call an immediate special session of Congress and ask it to make the appropriate changes in the Presidential succession law. Congress might simply add a provision, say, that the outgoing President could appoint the President-elect to some office in which the latter would ex-officio succeed to the Presidency on the resignation of the incumbent President and Vice President.

It need hardly be said that such a revised law should impose no economic penalties on resignation. It should provide that the salary of any President who resigned in this way would be continued until Jan. 20, just as if he had remained in office.

The new law should also, preferably, give each outgoing congressman or senator the same right of



immediate resignation in favor of his elected successor, under similar salary provisions. The date of transfer of office for congressmen and senators could then be any time between the day after election and Jan. 3, and for Presidents any time between the day after election and Jan. 20. The actual date of transfer, within this period, could vary in each case, depending purely on the mutual wish or convenience of the two parties directly concerned.

There would be nothing obligatory about such resignations. But once legal provision were made for them, and the precedent set, both outgoing congressmen and outgoing Presidents, we may be confident, would be eager to take advantage of it. Nobody likes the label or the status of a lame duck.

The change would be in accordance with the tradition of virtually every democratic government of Europe, and of every parliamentary government of the British Commonwealth, including our neighbor Canada. In such governments the executive does not attempt to carry on a day after he has lost an election or a vote of confidence. But the change here proposed would be more flexible.

The formal inauguration ceremony, of course, could still take place on Jan. 20, whether or not the office had actually changed hands prior to that date. It is not unusual, in democratic practice no less than in coronations, for a formal ceremony to take place after the actual fact that it solemnizes.

If you call a special session now, Mr. President, it may still be possible to reduce the present interregnum period by six or seven weeks. But much more importantly, you have the opportunity to set a permanent milestone in American history, and to avert the possibility of any future two-month paralysis of government which could have consequences as grave as that of 1860–61 or of 1932–33. ❁

## The Dream World of the MSA

November 24, 1952

Not least among gains achieved by the election of Mr. Eisenhower and a Republican Congress is that it provides an opportunity for reexamining both the details and the principles of our foreign-aid program.

A few days before the election a *New York Times* story disclosed the contents of a “secret Green Book” prepared by the Mutual Security Agency “as a basis for discussion of next year’s program.” And what its proposals chiefly reveal is that MSA officials have learned

absolutely nothing from mistakes of the past; that they are dreaming up more grandiose schemes than ever, involving still more bureaucratic agencies and jobs, still more economic controls, still more burdens on the U.S. taxpayer, still more drains on our national resources.

One of the proposals is for “a multi-billion-dollar currency stabilization fund to be called the Atlantic Reserve System.” The reader will not be surprised to hear that: “If coordinating the currencies of the North Atlantic community requires a substantial degree of pooling of resources, the major contributor to the pool by far must be the United States, which possesses over 80 percent of the gold reserves of the system.” Nor should he be surprised to learn of the hope of our MSA bureaucrats that “tying together the major currency systems of the Atlantic community . . . would end the preoccupation abroad with dwindling gold reserves that has prevented expansionist economic policies.”

In plainer English, this means that we are to be asked to give or throw away most of our gold reserves by allowing people everywhere to demand this gold in exchange for practically every European paper currency, no matter how overvalued, and that European governments are not only to be permitted but encouraged to continue the very paper money inflation (“expansionist economic policies” is the MSA euphemism) that causes gold drains.

This scheme is designed to bring about something called “managed convertibility.” The phrase (as well as the whole scheme) overlooks the fact that all currencies were freely convertible into each other when exchange rates and markets were free; that nothing but the existing exchange controls and other bureaucratic restrictions now obstruct this convertibility; that the system we have today is best described as one of managed inconvertibility; and that the way to get full convertibility is not by more management but by less of it.

The Atlantic Reserve System (so far as one can gather until further details are made available) is simply to be thrown on top of several organizations already designed to do virtually the same job—the International Monetary Fund, the International Bank, and the European Payments Union. This is another illustration of the bureaucratic maxim that what’s worth doing is worth overdoing.

Other schemes in the Green Book contemplate an “Atlantic Economic Board” and an “Atlantic Commodity Board.” The latter “would seek to stabilize production and prices of essential raw materials through long-term agreements with leading producer countries and thereby remove the need for restrictive

cartel arrangements.” In other words, the “need” for private cartels would be removed by setting up an enormous international governmental cartel, fixing prices and production quotas and allotting consumption quotas—in short, regimenting the world economy.

All this, it need hardly be said, is the very opposite of what the world now needs. What it desperately needs is a restoration of free markets, free prices, free production, free consumption, free trade. In the monetary field it needs an end to bureaucratic parlor tricks, to exchange control, to deficit financing, to artificially depressed interest rates, to more paper money. It needs a return to the gold standard. It is not foolproof and it is not perfect, but it is infinitely better than bureaucratic caprice.

What the world’s bureaucrats have still to learn, in brief, is that it is precisely their controls that create most of the problems they are trying to solve. ⚙

## Why Risk an Interregnum?

December 1, 1952

From 1886 to 1947, an outgoing President could have eliminated the dangerous four-month interregnum before the inauguration of his successor simply by his own act of resigning (together with the Vice President) after appointing the President-elect as Secretary of State. Though this possible course was closed by the Presidential succession act in 1947, it could be reopened by a mere amendment to that act. Such an amendment could be drafted and passed by Congress in less than a week. Yet rather than consider this simple step, many people who began by expressing concern over the risks of the eleven-week interlude before the inauguration of General Eisenhower are now trying to persuade themselves that the risks have been eliminated and the problem solved by a meeting of 70 minutes and a vague joint statement that amounts to little more than a gesture.

The truth is that an interregnum of eleven weeks between the election and inauguration of a new President is as needless, and potentially as dangerous, as the previous interregnum of four months. If it had not been for the interregnum of 1860–61, the disaster of the Civil War might have been averted. Without the interregnum of 1932–33, the banking panic of 1933 could certainly have been averted.

“Again and again,” wrote President Wilson to Secretary Lansing in 1916, “the question has arisen in my mind, what would it be my duty to do were Mr.

Hughes to be elected? Four months would elapse before he could take charge of the affairs of the government, and during those four months I would be without such moral backing from the nation as would be necessary to steady and control our relations with other governments. I would be known to be the rejected, not the accredited, spokesman of the country; and yet the accredited spokesman would be without legal authority to speak for the nation. Such a situation would be fraught with the gravest dangers.”

It would be his duty, he went on, “to relieve the country of the perils of such a situation at once,” and if he could gain the consent of the persons involved, he would “then join the Vice President in resigning and thus open to Mr. Hughes the immediate succession to the Presidency.” He concluded: “The whole country has long perceived, without knowing how to remedy, the extreme disadvantage of having to live for four months after an election under a party whose guidance has been rejected at the polls. Here is the remedy. . . .”

Today a change in the law would be needed to adopt this remedy. But advantage could be taken of this, as I suggested here two weeks ago, for Congress to provide specifically that the salary of any President who resigned for this purpose would be continued until Jan. 20, just as if he had remained in office. Certainly no economic penalty should be placed on such a voluntary surrender of office.

Congress could also use this opportunity to deal with the problem of the change-over of Cabinet members. It could authorize the incoming President to appoint for terms of a few months as many Secretaries-General as there were existing members of the Cabinet. Each of these could be assigned to work with his predecessor or chosen successor, as the case might be. No Secretary-General would be granted specific powers, but he would have the standing and salary of a Cabinet member and whatever secretarial help he needed.

None of the legislation here proposed would impose any compulsion on anyone. It would merely *permit* an outgoing President to resign and turn over his office on any date before the following Jan. 20 that was agreeable to his elected successor. It would give flexibility instead of dangerous rigidity to the period of change-over. Even if Mr. Truman, because of the delay involved by legislation, was not now able to transfer office to Mr. Eisenhower until a few weeks before next Jan. 20, he could still establish a fine precedent and remove a grave risk for the future. ⚙

## The Tools That Make Tools

December 8, 1952

A few weeks ago I attended and spoke before the annual meeting of the National Machine Tool Builders' Association, which this year celebrates its 50th anniversary. The machine-tool industry does not deal directly with the consuming public, but with other industries. It makes the tools that make tools, the machines that make machines. It turns out the machines that turn out trucks, tractors, automobiles, radios, television sets, refrigerators, washing machines, lawnmowers, watches, razor blades, milk bottles, shoes, suits, pills—almost anything you can think of. Machine tools themselves can only be made by other machine tools.

Surely the men in this industry do not exaggerate when they call machine tools the muscles of America; when they point out that the better our tools, the greater our capacity to produce, the higher our standard of living, the stronger our military security. For we must have machine tools to produce guns, bullets, shells, tanks, aircraft, battleships, and bombs. The machine tool is the very basis of America's industrial supremacy, of our whole mechanical civilization. It has enormously increased labor productivity. It is the secret of America's unparalleled wages.

For technical reasons, changes in the demand for and output of consumers' goods give rise to much more violent changes in the demand for and output of producers' goods. And as the machine-tool builders are producers' producers, they are the classic example of the prince-or-pauper, feast-or-famine, boom-or-bust industry. Yet Washington has been extremely slow to realize the industry's special problems. It was not until August 1951 that price relief and priority assistance were extended to it. The price-control program has been stupid generally, yet as applied to machine tools it was almost disastrous.

Instead of offering incentives and inducements for the expansion of the American machine-tool industry since the outbreak of war in Korea, the Truman Administration in the main has provided deterrents.

The so-called excess-profits tax discourages growth generally; but it is particularly discouraging to an industry subject, like machine tools, to extreme swings in profits. For this tax is liable to take years of low earnings as the "normal" base, and so take away an extra heavy slice of earnings in the rare good years. Its effect, in other words, is to cut much more heavily into the average profits of industries subject to wide fluctuations in demand than into the profits of industries benefiting from steady demand. In this way it is depriving the

machine-tool industry of the needed reserves for lean years, of reserves for survival, not to speak of funds for the expansion of plant, or for the research necessary to keep ahead of our potential enemies.

The same considerations apply to the renegotiation of government contracts. The general effect of this practice is to place an arbitrary limit on profits, and so undermine the incentive to economies and efficiency in production. It may be seriously questioned whether renegotiation does not reduce defense output below what it would otherwise be, and actually cost the government much more money in the long run than it saves.

Finally, the American machine-tool builder has watched with misgiving a foreign policy which has subsidized his European competitors with his own tax dollars and then effectively prevented him from selling his own goods in the foreign market. Does it make sense even from a military standpoint, he asks himself, for us to build up the European machine-tool industry at the expense of our own, when Stalin's hordes could overrun Europe and then use all this equipment against us?

The recent proposal by Henry Fowler, the Defense Mobilizer, to set up a government stand-by reserve of machine tools to be ready for use in the event of full-scale war is a step in the right direction. But the new administration should reexamine the whole policy toward the machine-tool industry—and, for that matter, toward industry in general. ❁

## The Cabinet Change-Over

December 15, 1952

Some readers may have wondered why a column devoted to business tides has been discussing the "political" problems of an Administration change-over. The reason is that the uncertainties created by the interregnum period can have, and have had, profound effects on business. The bank panic of 1933 was the direct result of the interregnum. That panic caused great unemployment and suffering for years. Its effects are still felt in the retention of such mischievous institutions as the Reconstruction Finance Corp., in the persistence of inconvertible paper money, and in the excessive dread of deflation that has helped to cause continued inflation.

American action could be temporarily paralyzed even now if, for example, the Communist world should make some unexpected aggressive move before the present interregnum was over. And whatever threatens our national security of course profoundly affects business.

Yet there is great national reluctance to consider even minor changes affecting the Presidential office.



Though the Constitution makes explicit provision for the resignation of a President, there is a curiously widespread notion that it would be “unconstitutional” for a President to resign before his term expired on Jan. 20. And the proposal that a President be merely *enabled* by law to resign in favor of his elected successor is regarded by some as directed against the incumbent—though such a precedent, once set, would almost certainly control all his successors.

Fortunately, it is possible to discuss the change-over of a Cabinet with comparative freedom from the misconceptions and prejudices that encumber the discussion of a change-over of the Presidential office. And the Cabinet problem urgently needs consideration at this time. For months Defense Secretary Lovett has expressed a wish to be able to brief his successor fully before that successor takes office. General Eisenhower has taken the unprecedented step of naming his full Cabinet long in advance of his inauguration. His Secretaries-designate have already been holding conferences with incumbent Secretaries.

The new procedure undoubtedly serves the public interest. Yet under existing law it is unfair to the President-elect and his appointees. If they are expected to begin working on their new jobs even before officially taking office, then they ought not to be asked to do it without compensation. Congressman Hugh Scott says it is costing some \$20,000 a week to keep a staff of 90 to 100 persons in the Eisenhower headquarters in New York, and that it is necessary in the public interest to keep this organization until Jan. 20. But the funds for it must now be supplied by private subscription.

There is a simple way in which Congress could deal equitably with this situation. It could authorize both an outgoing and a newly inaugurated President to appoint an Alternate Secretary for each existing Secretary. This Alternate would have the rank and the salary of a Cabinet member, and a modest budget for temporary clerical help. As his tenure would have a maximum duration of, say, three months, and as he would have no independent powers, his appointment would not need to be made subject to Senate confirmation.

With such legislation on the books, the President-elect could forward to the outgoing President a list of his intended Cabinet appointments. The outgoing President, as a courtesy, could name these as Alternate Secretaries. Even if this course were not feasible in a given case, the new President, when naming his new Cabinet after he took office, would still be empowered to name members of his predecessor's Cabinet as Alternate Secretaries for a few weeks to give them time to brief their successors.

This legal provision for a smoother, fairer, and more orderly Cabinet change-over could either be made by Congress independently, on its own merits, or together with a provision permitting more flexibility in the change-over of the Presidential office. ❁

## The Collapse of Controls

December 22, 1952

On Oct. 18, the Wage Stabilization Board rejected the proposed increase of \$1.90 a day for soft-coal miners. It ruled that \$1.50 was the highest increase allowable under the stabilization policy. The miners then went on strike. This was embarrassing to Mr. Truman at the height of the election campaign. He saw John L. Lewis, and the strike was called off. As it is well-known that Lewis does not call off a strike and leave for South America merely on a nebulous promise that his case will be “reconsidered,” it was widely assumed that Mr. Truman had given him a definite assurance that he would retroactively approve the full \$1.90.

Post-election developments have done nothing to shake this assumption. Mr. Truman's action of Dec. 3, in discarding the counsel of his own stabilization officials and overruling his own wage board to grant the full \$1.90 increase, stripped the last veil from any pretense that wage and price control was being administered honestly and evenhandedly.

The chairman of the board, and its industry members, promptly resigned. The chairman's statement explained why he could not “usefully or conscientiously continue.” The industry members explained why they could not “be parties to what we believe to be the perpetration of a fraud upon the American people.” “If your action,” they wrote to the President, “means that the small and the weak are to be restricted by wage controls, while the big and the powerful are to be allowed whatever excessive increases result from the threat of a paralyzing strike, then there no longer exists the equality with which all law and all regulation should be applied in a republic. . . . We cannot participate in a program which would require us to grant special privilege to a few, and to make second-class citizens of all others.

“On the other hand, if your action means that all employers and employees may put into effect increases as far in excess of sound stabilization policy as those you have approved for the coal miners, then we must advise again, as both we and the board's public members advised in our coal case opinions, that wage controls become an empty shell, and a fraud upon the people.”



This logic is inescapable. The efforts of Mr. Truman and his remaining “stabilizers” to rationalize his action have only involved them in further contradictions and absurdities. Mr. Truman pretended that he overruled his own board just to save Mr. Eisenhower from a coal strike. But if he openly yields to every major strike threat, he cannot still pretend to have a stabilization program. Yet he does: “It is therefore my firm intention to continue a strong stabilization program and turn it over to the new Administration as a functioning, effective entity. If the new Administration then wants to scrap price, wage, salary, and rent controls it will be free to do so on its own responsibility.”

The intent behind this is transparent. It is to destroy the substance, and preserve the form; to act “for the record”; to destroy the fact of wage control but to keep the pretense—and then put the blame for “scrapping” the program on the Republicans.

Meanwhile Mr. Truman’s stabilizers talk solemnly of “sealing off” the coal wage increase from the rest of the economy. This neat trick would require not only putting the entire burden on the coal companies, but refusing to all other unions the increases granted to the coal miners.

The new Administration should now drop all wage and price controls—not because Mr. Truman did not administer them honestly and impartially, or because “the need for them has now passed,” or because it would be politically difficult to restore them, but because they are wrong in principle. They do not prevent or combat inflation; they merely curtail and unbalance production. They owe their existence to blind envy and economic ignorance. Inflation is caused by the excessive creation of money and bank credit. At the same time as Congress drops wage and price controls, it should take steps to see that the continuous manufacture of more money and credit is brought to a halt. ❁

## The Age of Envy

December 29, 1952

I take the title from that of an excellent article in the September issue of *U.S.A.* by Helmut Schoeck, professor of philosophy and religion at Fairmont State College, West Virginia. Dr. Schoeck in his article quotes some words of mine from this place, and I am borrowing in turn a few of his points to write a variation on the same theme.

Envy has been an attribute of human nature from the dawn of history. But it has always hitherto been regarded as a sin. Ovid thought it “the meanest of the

vices.” The Bible calls it a “rotteness of the bones.” “From envy, hatred, and malice, and all uncharitableness,” says the *Book of Common Prayer*, “Good Lord deliver us.”

Yet today envy is glorified as a virtue. Politicians advocate measures, not because they will bring any material benefit to anyone, but on the ground that they may assuage the public envy which they themselves have helped to inflame. Hitler promised that nobody would be permitted to have an income of more than 1,000 marks a month or be allowed to live on the income from investments. Franklin D. Roosevelt once proposed a limit of \$25,000 a year on incomes.

People sometimes become Socialists or Communists through a desire to abolish poverty, but when their ill-conceived schemes fail to bring this result, their feeling too often degenerates into mere hatred and envy of the rich. The success of Marx sprang from his contemptuous dismissal as “utopianism” of all peaceable or constructive attempts to relieve poverty, and from his naked appeal to hatred, envy, and class warfare against the well-to-do and successful.

The prevailing ideology today is a diluted form of Marxism, even on the part of many of those who think themselves anti-Marxist or anti-Communist. The emphasis of most “welfare state” proposals today is on hurting or impoverishing the rich rather than on helping or enriching the poor. Most of these measures surely accomplish the former, and usually the opposite of the latter. They level down, not up.

Envy is the main drive behind the present fantastic tax rates on the upper-income brackets. “It should be remembered,” writes David McCord Wright, “that these high progressive rates have almost no revenue significance. They yield only a pittance compared with other taxes and the size of the government budgets. They are merely the reflection of ‘ethical’ prejudice.” It may be added that these rates, by choking incentives and draining savings, do incalculable harm to workers and to the poor. They retard the very growth of capital upon which the growth of productivity and real wages depends.

All this is even truer of the present rates of death and inheritance taxes. Even belligerently New Deal economists admit that such taxes “are unimportant as revenue producers, having as justification only our desire for less inequality of income and wealth”—in other words, the present passion for leveling down.

The main drive behind the so-called excess-profits tax is also to appease envy. The tax ignores the vital function of profits as the chief incentive to efficiency and economy and the regulator of production. It

promotes waste and reduces war output. It is defended by such high-sounding slogans as: "No one must be allowed to profit from war." It would be just as logical to say that no one must be allowed to profit from sickness, or from death, or from arson, or from crime, and for that reason to refuse to pay doctors or undertakers or firemen or policemen. This is envy masquerading as a passion for justice. The general rule of free enterprise is not unjust. It is "to each in accordance with what he contributes; to each what he creates." The way to

achieve maximum output for war is to reward each in proportion to the value of his output.

In the Christmas season, above all, we should remind ourselves that this modern glorification of envy is not part of the Christian ethic. That ethic teaches not envy, but charity and compassion. It advocates individual *voluntary* help to the less fortunate, not forcible seizure.

"Charity suffereth long and is kind, charity envieth not." ❁



1953





## Is a Depression Coming?

January 5, 1953

I put the question in this extreme form because so many people put it that way after the election of General Eisenhower and a Republican Congress. That is because they were conditioned by twenty years of New Deal propaganda to assume that “Republicans-in-power” and “depression” were synonyms, or that the second followed automatically from the first.

But there is an assumption of a quite different nature in the minds of many who raise the same question. This is that booms and depressions originate wholly within the economic system, in accordance with mysterious laws of their own, not subject to alteration or control by political policies. The opposite assumption, on which most politicians operate today, is that governments have now surprised all the secrets of the business cycle, mastered all the devices for countering either an inflation or a slump, and have the will to “keep the economy on an even keel.”

Neither of these extreme assumptions is true. The ups and downs of business are partly due to what economists call “endogenous” conditions, originating from “inside” the business system, and partly due to “exogenous” influences from “outside.” The minor fluctuations seem to be most often endogenous and the major fluctuations exogenous. War or peace, a larger or smaller defense program, extreme monetary inflation or deflation, are “exogenous.”

This is one of the complexities that makes business forecasting such a hazardous occupation. Among their other headaches, the forecasters must try to guess what the politicians are going to do. If Mr. Truman had continued in power, the major guess could have been reasonably safe. He would have continued to inflate. Or more accurately, he would have continued the policy that has come to be known in most countries as “repressed inflation.” This consists in depreciating the dollar by increasing the money and credit supply—then pretending that the consequent rise is the result of “profiteering” and “greed,” and “fighting” it with price control.

The government’s inflationary policies have led to an increase in the country’s supply of money and bank credit from \$65,000,000,000 at the end of 1939 to \$175,000,000,000 at the outbreak of war in Korea in June 1950 and to \$196,000,000,000 now. The outlook for 1953 has now been radically changed, however, by the coming of a new Administration. General Eisenhower’s appointments, both in the Federal Reserve System and in the Treasury, are tremendously encouraging. He has

asked William McChesney Martin, Jr. to stay as chairman of the Federal Reserve Board. Martin is a strong believer in a Reserve system free from Treasury domination. The Secretary-designate of the Treasury, George M. Humphrey, has appointed Marion Folsom, treasurer of the Eastman Kodak Co., as Under Secretary, and W. Randolph Burgess, chairman of the executive committee of the National City Bank, as special assistant. The appointment of Burgess is particularly heartening. Few men in this country understand the problems of monetary policy and debt management as thoroughly as he does, and none has better recognized the need for an independent Reserve system.

These men are evidently determined to halt inflation, but their efforts will need public understanding and support. One weakness of trying to continue inflation is that in its later stages it inevitably gets more and more out of control. But trying to halt it also entails serious problems. Inflation always brings discrepancies in price and cost rises, distortions in demand and production, and a great deal of misdirected investment. When the inflation is brought to a halt serious readjustments are unavoidable. They are certain to mean recessions in some lines. We must understand the necessity for these readjustments and be willing to accept them. In that case they can be comparatively mild and short-lived. But if we try to prevent or postpone them by still further inflation, we only build up a much graver ultimate reckoning. ❁

## A Fallacy in the Forecasts

January 12, 1953

A business forecast, as frequently explained in this column (see “Pitfalls of Forecasting,” *Newsweek*, Nov. 22, 1948), can never be anything better than a guess. The future of business depends on countless factors, and no human mind can encompass them all. But some guesses are better informed and better reasoned than others. What troubles me about the current crop of forecasts for 1953 is that most of them rest on fallacious assumptions. The most important of these is the assumption that the future of business activity at this time depends primarily on the government’s defense-spending program. If that rises, we are told, business activity and prices will rise; if it is sustained, the boom will be sustained; but if it declines, there’s no telling how much business will deteriorate, unless the government steps in and does something desperate.

This is the assumption, for example, that runs through the 80,000-word report on “Markets After the Defense Expansion” released by the Department of Commerce on Dec. 29, 1952. The report thinks it a “strong probability” that business will be good in 1953, but fears it will turn down in 1954—both largely based on the assumption that defense spending will rise next year and decline thereafter.

If this were true, it would mean that the more resources we are forced to devote to making guns and tanks and shells, instead of consumer goods, the richer we become. Many people do in fact embrace this absurdity. They even go on to tell you with a knowing wink that we owe our prosperity to Stalin and Korea, and that if a real peace broke out it would be an economic disaster.

This conclusion is just as preposterous as it seems. People arrive at it by combining a fallacy with an illusion. The fallacy consists in looking only at the government’s defense payments and forgetting that the money for these comes ultimately from taxes. If defense payments suddenly dropped from the present \$50,000,000,000 a year to only \$10,000,000,000, taxes could also be cut by \$40,000,000,000. Then the taxpayers—both individuals and corporations—would have \$40,000,000,000 more to spend than they had before, to make up for the \$40,000,000,000 drop in government spending.

Of course such a change would very importantly affect individual industries. Defense output would be hurt as much as nondefense output would be helped. The pattern of production would be transformed. But there is no reason to suppose that the overall volume of output or activity would decline.

The confusion here arises because defense buying is most often financed by inflation. Instead of taking from the taxpayers the money that it uses to buy war goods, the government in effect prints the added money. But we can easily have inflation (if that is what we want) without defense spending. If we simply cut tax revenues by the same amount as we cut defense spending we can keep the same deficit and finance it by continuing to print money. In fact, most of the people who believe that continued prosperity depends on continued defense spending are logical enough to advocate inflation in some other form if we ever have to terminate defense inflation.

It is strange that the superstition that defense spending is necessary for continued prosperity should still prevail. The whole theory got a crushing refutation at the end of the second world war. Immediately after Japan surrendered in August 1945 there was a

sweeping cancellation of war contracts. Government economists predicted that unemployment would reach 8,000,000 by the following spring. Nothing of the sort happened. By May of 1946, employment was actually higher than in July of 1945. So were prices. The primary reason was that the government continued to inflate the active money and credit supply. This was pushed up \$8,000,000,000 between the beginning of August 1945 and the end of that year. I don’t put this forward as an argument for monetary inflation, but as proof that prosperity is not dependent on defense contracts. ❁

## Estimates vs. Realities

January 19, 1953

Early January is the time when the forecasters, many of them in the government, tell us exactly what the gross’ national product is going to be in the year ahead, and how much 45,500,000 different families are going to spend. Unfortunately for the forecasts, it is also the time when the President presents his budget. The record for the completed fiscal year behind him, as well as his revised estimates for the current fiscal year, remind us that, so far from being able to predict what everybody is going to earn and spend in the year ahead, government officials can’t even predict successfully what the government itself is going to take in and hand out.

Yet contrast the appallingly bad estimates of our own Presidents over the last twenty years with those of George Goschen, for instance, the British Chancellor of the Exchequer from 1886 to 1892. He had none of our ultra-modern statistical techniques. He was utterly ignorant of Keynesian economics. But somehow, year after year, he stumbled on incredibly accurate budget forecasts. For 1892–93 for example, he forecast expenditures at £90,253,000; actual expenditures were £90,375,000. He forecast revenues at £90,453,000; actual revenues were £90,395,000. He missed by only six-hundredths of 1 percent.

The table below compares, for each year since 1934, the President’s estimates (in millions of dollars) of expenditures, receipts, and deficits for the following fiscal year with the realities of that year. We still do not have a responsible budget system. And maybe, also, we haven’t learned as much about economic forecasting in the last 60 years as we think we have.

Fiscal Year	Budget Estimate	Reality	Percent Difference
<b>EXPENDITURES</b>			
1935	\$ 5,961	\$ 6,802	+ 14
1936	7,884	8,477	+ 8
1937	6,173	8,001	+ 30
1938	5,756	7,626	+ 32
1939	6,869	8,707	+ 27
1940	8,995	8,998	...
1941	8,424	12,710	+ 51
1942	17,486	32,397	+ 85
1943	58,928	78,178	+ 32
1944	104,128	93,743	- 10
1945	97,954	100,405	+ 2
1946	82,530	63,714	- 23
1947	35,125	42,505	+ 21
1948	37,528	33,791	- 10
1949	39,669	40,057	+ 1
1950	41,858	40,156	- 4
1951	42,439	44,633	+ 5
1952	71,594	66,145	- 8
1953	85,444	*74,593	- 13

Fiscal Year	Budget Estimate	Reality	Percent Difference
<b>NET DEFICIT</b>			
1935	\$ 1,986	\$ 3,002	+ 51
1936	3,892	4,361	+ 12
1937	519	2,707	+ 422
1938	sur. 1,538	def. 1,384	...
1939	950	3,542	+ 273
1940	3,326	3,611	+ 9
1941	2,176	5,103	+ 135
1942	9,211	19,598	+ 113
1943	42,441	55,897	+ 32
1944	71,047	49,595	- 30
1945	57,185	53,948	- 6
1946	41,530	20,676	- 50
1947	def. 3,612	sur. 754	...
1948	sur. 202	sur. 8,419	+ 4,068
1949	4,808	def. 1,811	...
1950	873	3,111	+ 256
1951	def. 5,133	sur. 3,510	...
1952	16,456	4,017	- 76
1953	14,446	*5,896	- 59 🌀

\*Revised estimate

<b>RECEIPTS</b>			
1935	\$ 3,975	\$ 3,800	- 4
1936	3,992	4,116	+ 3
1937	5,654	5,294	- 6
1938	7,294	6,242	- 14
1939	5,919	5,165	- 13
1940	5,669	5,387	- 5
1941	6,248	7,607	+ 22
1942	8,275	12,799	+ 55
1943	16,487	22,281	+ 35
1944	33,081	44,148	+ 33
1945	40,769	46,457	+ 14
1946	41,255	43,038	+ 4
1947	31,513	43,259	+ 37
1948	37,730	42,211	+ 12
1949	44,477	38,246	- 14
1950	40,985	37,045	- 10
1951	37,306	48,143	+ 29
1952	55,138	62,128	+ 13
1953	70,998	*68,697	- 3

## How to Cut the Budget

January 26, 1953

No one will take Mr. Truman's budget for the fiscal year 1954 very seriously, and there is no reason why anyone should. It is, to begin with, a legal absurdity that an outgoing President should be required to frame and present a budget for a year in which he will not be in office and for which he cannot and should not assume any responsibility. Mr. Truman's budget estimates even for years in which he was in office were hopelessly wide of the mark. He overestimated expenditures for the current fiscal year, according to his revised estimates, by some \$11,000,000,000.

But the budget for 1954 is not irresponsible merely because Mr. Truman framed it. As I have pointed out repeatedly in this column, we have an irresponsible budget system. It will continue to be irresponsible as long as Congress insists on the right to increase appropriations, even beyond those the President asks for.

Meanwhile, promises of substantial budget cuts cannot be taken too seriously. The economizers have



become timid even in their talk. The “economy extremists” among Republicans hardly dare mention a cut of more than \$10,000,000,000. Yet if we take the Truman estimates at face value, we confront a deficit of \$10,000,000,000 in the fiscal year 1954 even if we continue all present taxes. If we allow the excess-profits tax to expire on schedule this June 30 (and the termination of this tax is essential to the health of the economy) it might require a slash of \$12,500,000,000 in proposed expenditures to balance this 1954 budget.

Contrary to most of what is now being written, it should not be at all difficult or dangerous to make such a slash. When General Eisenhower last June ventured the opinion that the Federal budget could be cut as much as \$40,000,000,000 in the next few years, he was scolded even by Senator Taft. But is that goal really so extreme? After all, even in the fiscal year 1951 expenditures were \$30,000,000,000 less than the estimate for the present fiscal year. In the fiscal year 1950 expenditures were \$38,000,000,000 less than estimated expenditures for the fiscal year 1954.

Two main lines of argument are now put forward against serious economy efforts. One is the familiar device of treating every expenditure as sacred to which the label of “defense” can be plausibly attached. This is like a spoiled son’s argument that it is unreasonable to ask him to cut down his spending at the Twenty One Club or the Chambord Restaurant because a fellow has to eat. No one, it is true, could say prior to an investigation by experts just how much our military expenditures could now be safely cut. But what we do know is that almost every Congressional investigation of military expenditures in the last few years has revealed shocking lavishness and waste.

It is doubtful, moreover, whether whole allegedly sacrosanct categories of expenditures, such as the \$7,800,000,000 budget for foreign economic and military aid, can be justified even in principle. The real argument put forward for the military aid is in fact not military but economic. It is the plea that European nations cannot afford to pay for their own defense. The evidence behind this plea has been far from convincing.

The second main line of argument against substantial budget cuts is that enormous sums have already been appropriated or “committed.” But Congress is not impotent. It can review unexpended appropriations, direct that some of them be used in lieu of new appropriations, or authorize the President to curtail expenditures by executive and administrative orders. The amounts that really have been morally and irrevocably committed by Congress are far smaller than most of the present estimates.

Space unfortunately does not permit me to discuss the various procedural reforms recommended by Senator Byrd, Representative Coudert, and Herbert J. Miller of the Tax Foundation, to make our Federal budget more responsible and controllable. But if the will to economy exists, the way is certainly not closed. ❁

## Making Currencies Convertible

February 2, 1953

Exchange control is a totalitarian device which until the outbreak of the second world war was confined to Communist Russia and to Nazi Germany. The democracies fighting Hitler themselves adopted exchange control, imitating Schacht’s techniques, after they became involved in the war. But no responsible statesman in the democracies suggested at the time that exchange control was anything but a war-emergency measure. In fact, though a necessary and inherent part of a totalitarian economy, it is completely incompatible with a free one. Yet England and nearly all the continental countries have retained exchange control since the war. It is the chief cause of their so-called “dollar shortage,” of their “international payments difficulties,” of their chronic excess of imports over exports, of “currency inconvertibility.”

Exchange control is a form of price fixing applied to money itself. The government of a country attempts to fix by fiat the rate at which its citizens are allowed to buy or sell its paper currency in terms of other currencies. This is only another way of saying that the government of a country under exchange control attempts to fix the price at which the currencies of all other countries are allowed to be bought or sold in terms of its own.

The consequences are like the consequences of price fixing in any other field. If the price of meat is arbitrarily fixed by an OPS below what it would bring in a free market, the consumption of—or demand for—meat increases, the supply coming to market diminishes, and there is very soon a “meat shortage.” So the next steps are consumer rationing, slaughter-hour licensing, processing quotas, and so on. In the field of currency, similarly, if the British pound is arbitrarily fixed at a price of \$2.80 when the market thinks it is worth only \$2.63, there is a “dollar shortage” because dollars are underpriced. Then dollars must be rationed through the imposition of import quotas, and international trade is put under an incredibly complicated system of licensing and controls.

This regiments and strangles an economy far more seriously than any other form of control. Through a

system of import licenses and quotas, a government can fix the exact amount of raw material that a given industry or individual firm may use. In that way it can freeze an industry or a firm at any size it wants. It can exercise life-and-death powers over every business or firm that depends on imports. It can indirectly freeze the whole economy and get the entire business community accustomed to lack of freedom, lack of initiative, and lack of incentive. But it can never basically cure the “dollar shortage” that its exchange control has itself created.

Ever since the Bretton Woods agreements of 1944, a bare handful of writers, including myself, carried on a rather lonely battle against exchange control. A terrific crack in the system came in September of 1949; but instead of a return to free markets, there were worldwide devaluations of currencies unparalleled in history. Today the battle against exchange control is no longer forlorn. The turn of the tide may be dated from Dec. 14, 1951, when Canada completely abandoned exchange control. The immediate flow of funds and investment into Canada instead of out, and the rise of the Canadian dollar against the American dollar, was the opposite of the consequence usually feared by those who are afraid to abandon exchange control in their own countries.

The argument against exchange control has now received powerful support in the January letter of the National City Bank of New York. The bank points out that \$38,000,000,000 of American postwar aid to foreign countries has not cured their dollar shortage. It doubts that the fantastic proposal of *The London Economist* for an additional \$35,000,000,000 contribution from us would cure it. It points out that free convertibility of the paper pound was successfully maintained in a fluctuating market over the period 1931–39. And it insists bluntly that the way to get convertibility is to let the free market do the job. “The way to make currencies convertible is to make them convertible.” ❁

## Convertibility vs. Control

February 9, 1953

British Government officials are said to have a plan to make the pound sterling freely convertible with the American dollar. The aim is laudable; but there are grounds for grave misgivings concerning the method that may be proposed to achieve it.

One step is indispensable. Britain must abandon exchange control. It must let the sterling rate go free. It must stop forbidding people to exchange pounds for dollars on any terms they can agree upon. The way to

restore currency convertibility, in short, is simply to permit it.

Hitherto British officials have been frightened by the mere mention of convertibility. They cannot forget the quick collapse of the effort to make sterling convertible in the summer of 1947. But they still misinterpret the result. Britain was drained of dollar and gold reserves in those few weeks, not because the government had made sterling convertible, but because it had done so on the basis of a fantastically false conversion rate with the dollar. On Sept. 18, 1949, British officials at last admitted that the pound had been grossly overvalued. They slashed the official rate overnight from \$4.03 to \$2.80. But they failed to recognize even then that the only “realistic” rate for the pound is a free-market rate.

One would like to think that the subject is better understood now. Yet typical of the confusion which still exists even at the highest levels of British economic thought is the article by Prof. Lionel Robbins in the January issue of *Lloyds Bank Review* of London. This article makes some very sound points in an admirable way. It recognizes the weaknesses of “imperial preference.” It exposes the fallacies of the argument, seriously put forward by influential British and other European writers on economics, that productivity in the United States is so much greater than in England or elsewhere that trade equilibrium is impossible without a permanent aid program. As Professor Robbins points out: “The great principle of the division of labor is founded on just such differences; if there were no differences in productivity there would be no advantage in trade.”

But when it comes to the central issue Prof. Robbins still puts the cart before the horse. He is still opposed to currency convertibility through free exchange rates, the indispensable requirement for full convertibility. “I am yet to be convinced,” he writes, “that the dilemma is escapable that, when the general financial position is strong, free rates are usually unnecessary and that, when it is weak, they are apt to be a source of appalling danger.”

The real “dilemma” is in fact the reverse of this. When the general financial position of a country is strong, a pegged rate for its currency is unnecessary; and when it is weak, a pegged rate is an appalling danger. A pegged rate for the pound, higher than what a free market rate would be, necessarily brings a “dollar shortage.” It creates a chronic excess of imports over exports. It diverts production into the wrong channels, by reducing the relative incentives to export. It encourages the continuance of internal inflation. A pegged rate destroys the pressure-gauge readings by

which everyone could measure the extent of inflation and the changes in world confidence in the currency. You cannot tell the real condition of the patient if the thermometer is pegged at 98.6 degrees or the exchange rate at \$2.80.

There is no historic justification for Professor Robbins's fears of a free or "floating" rate for the pound. Convertibility of the paper pound was maintained in a fluctuating market over the period from 1931 to 1939. Canada's return to a "floating" dollar has been followed by a rise, not a fall, in the quotation for its currency.

Of course, a "floating" rate, one can hope, would be merely transitional to an eventual return to a gold standard. But Professor Robbins does not even hint at this last possibility. American taxpayers should not be called upon to contribute another dollar to the maintenance of exchange control in Britain or anywhere else. ❁

## Toward a Free Economy

February 16, 1953

President Eisenhower's State of the Union message to Congress marked a turning point in American history as dramatic and unmistakable as the early messages and fireside talks of Franklin D. Roosevelt twenty years ago. Roosevelt proclaimed the birth of the New Deal; Eisenhower delivered its funeral oration. The Roosevelt-Truman philosophy led us deeper and deeper into a managed economy; Eisenhower reasserted the philosophy of a free economy.

The contrast with the previous Administration was most striking in the discussion of price control. This lay not merely in Mr. Eisenhower's decision not to ask for a renewal of the present price- and wage-control legislation which expires on April 30, but in the reasons that he gave for this decision. He began by pointing out—what has never been clearly acknowledged in the executive branch in the last two decades—that the basic cause of inflation is government policies themselves. He knows just what those policies are and what must be done to halt them:

"The first order of business is the elimination of the annual deficit. . . . A balanced budget is an essential first measure in checking further depreciation in the buying power of the dollar." He wisely warned that expenditures should be reduced before any reduction of taxes. He called on the Federal Reserve Board for proper restraint on credit expansion. And then he pointed out: "The great economic strength of our

democracy has developed in an atmosphere of freedom. . . . Direct controls, except those on credit, deal not with the real causes of inflation but only with its symptoms. . . . American labor and American business can best resolve their wage problems across the bargaining table. . . . Controls in their present forms . . . have proved largely unsatisfactory or unworkable. They have not prevented inflation; they have not kept down the cost of living. . . . I am convinced that now—as well as in the long run—free and competitive prices will best serve the interests of all the people."

With equal wisdom Mr. Eisenhower recommended that "material and product controls should be ended, except with respect to defense priorities and scarce and critical items essential for our defense." In spite of this clearly thought-out position, which apparently has the full support of Congressman Wolcott, who heads the Banking Committee of the House, of Speaker Martin, and of Senator Taft a group in Congress headed by Homer E. Capehart, chairman of the Senate Banking and Currency Committee, still wish to give the President "stand-by" powers over prices that he has not asked for. The mere existence of such stand-by legislation would bring an element of crippling uncertainty into innumerable business decisions, particularly those involving long-range plans and long term price contracts. Senator Capehart even wants to retain a skeleton controls organization. This would mean the retention on the public payroll of people with nothing to do—but nonetheless with a vested interest in persuading the President, Congress, and the country that the imagined "emergency" for which they had been retained had already arrived.

The economic soundness of the Capehart proposal needs to be seriously examined. Inflation can be prevented by proper monetary and fiscal policy; but if it is not, then it only does added harm to try to disguise the inflation by price control. For in time of total war, price rises for particular products, and *relative* changes in prices, induce conservation in the use of scarce goods, and lead to maximum production most quickly of the things that are most needed. Efforts to prevent these relative price changes do not speed up economic "mobilization" for war, but retard or prevent it.

As for the immediate situation, the Administration will probably find that once a definite date has been set, a few months off, for the termination of price and wage controls, it becomes almost impossible to relinquish such "controls gradually." The simplest and most workable procedure is to lift them immediately. ❁



## Farewell to Price Controls

February 23, 1953

President Eisenhower recommended the removal of price and wage controls for the right reason—because “free and competitive prices will best serve the interests of all the people, and best meet the changing, growing needs of our economy.” But the termination of controls has probably met its widest approval for the wrong reason—that they are “no longer needed” except for prices “pressing upward against their ceilings.” People who now acquiesce in the removal of price controls only for this reason will be demanding their reimposition at the first sign of another price rise. What we need to understand, if we are not to be easily stampeded into taking controls back, is that wherever conditions of real competition exist price fixing is *always* harmful. It is never more so than when “prices are pressing upward against their ceilings”—i.e., when they are being arbitrarily held substantially below the levels to which the free play of supply and demand would bring them. For prices have constant and indispensable functions to perform. Their changes give the quickest and best information obtainable concerning the existence and extent of surpluses and shortages of supply in relation to shifts in demand. They also promote the quickest and most efficient adjustment of supply to meet a new pattern of demand. A higher price for a scarce commodity is an immediate deterrent to its wasteful consumption and an immediate incentive to its increased production. The free play of prices, in brief, can bring a quicker conversion from peacetime output to war-needed output than any set of bureaucratic regulations.

Why, then, is there so much clamor for the imposition of price controls when a war breaks out? One reason is embodied in the specious slogan: “No one must be allowed to make a profit out of war.” But any control that slows down war production and brings shortages of vital goods merely aids the enemy.

Another reason for the clamor for controls is a predilection for price “stability” for its own sake. But price stability at the cost of shortages and disrupted production is too dearly bought. That a free price sometimes shoots up and then falls again is never a proof (though price controllers invariably regard it as one) that the price flurry was unnecessary. It probably brought about the very increase of supply that corrected it. A more sophisticated argument for price control is that the supply of some goods is “inelastic,” so that even a great increase in their price will not lead to an appreciable increase in their supply or rate of output. Only in rare cases does this academic contention describe

actual facts. What those who make it usually have in mind are such things as housing, where the supply is not really “inelastic” but tends to respond to changes in price, rent, or demand only after a production-time lag. Yet the existence of such a lag is not a good reason for losing further time by forbidding any price incentive at all. And whether or not a rise in price brings an immediate increase in supply, it forces more economical consumption. A favorite analogy of those who argue that price control is indispensable in “total war” is that of a city under siege. The analogy is misleading. A city under siege cannot produce its own food, water, or fuel; a nation at war usually can. Price ceilings are usually harmful, moreover, even in a city under siege. They remove one of the chief deterrents to wasteful consumption. Priorities, allocations, and rationing may, of course, prove indispensable in a city under siege and in a nation engaged in total war. But priorities and rationing best achieve their purpose *without* price ceilings. Such ceilings merely give compulsory rationing more work to do.

But the rise in the average level of prices in wartime is caused chiefly by an increase in the supply of money and bank credit that the government has deliberately encouraged or enforced. But if the money supply is firmly controlled, there can be no spectacular general price advance and no excuse for government price ceilings. ❁

## The Price of Disinflation

March 2, 1953

We shall soon learn whether the American people really want to halt inflation, and whether they are willing to pay the price.

President Eisenhower has shown great political courage in his own resolve to halt inflation. What is perhaps even rarer in our political life, he has shown a clear understanding of the steps that must be taken. He and his chief financial advisers also see these steps in their proper order. First we must cut expenditures enough to balance the budget. From then on we can cut both expenditures and taxes by the same amount. Meanwhile we must stop using the banks as a dumping ground for additional government securities, and stop holding down interest rates arbitrarily. In brief, we must stop inflating the money supply.

But this program is already meeting serious opposition. Even the Republicans in the House want to start cutting taxes right away, and talk about cutting expenditures later. (The House Appropriations Committee,



however, at least made an excellent start by cutting the first spending bill before the new Congress from a requested \$2,300,000,000 to only \$904,000,000.)

Again, the new Secretary of Agriculture, Ezra Taft Benson, ventured to make some rarely sensible and courageous remarks about price-support policy, and a Democratic senator has already called for his dismissal. Though Mr. Eisenhower has promised to support farm prices at 90 percent of "parity" until December 1954, as required by present law, the opposition is already talking hysterically about the decline in farm prices and shouting that even the present inflationary support program is not enough.

But the opposition to a halt in inflation threatens to become even greater than this. Nearly all of us think we are against inflation, but most of us, on examination, are two-faced about it. We are deflationists in our role as consumers, but inflationists in our role as producers. We want to see the prices of what we buy go down, but the price of what we sell go up. City workers think food prices are too high; farmers think industrial wages are too high. Yet though beef and veal are still selling at retail at 193 percent above the 1935–39 level, as compared with only 91 percent above as the average for all items, many who presume to speak for the cattle raisers are already talking about the recent fall in beef prices as if it were an intolerable disaster. And though average weekly factory wages are 222 percent higher than in 1935–39, compared with an increase in living costs of only 91 percent, the American Federation of Labor recently called upon all its affiliated unions to press for still higher wage rates this year "as a necessary measure to head off a major depression in 1954 or 1955." Another substantial boost in wage rates now, in fact, without a further expansion of the money supply to make the wage boost payable, would be precisely the way to bring on unemployment.

But the opposition to halting inflation will not come merely from farm and union leaders. To halt inflation may require a further rise in interest rates. This will be opposed by many business borrowers at the banks—precisely because it would discourage a further expansion of bank credit.

Just as inflation never means a uniform rise in all prices, so a halt to inflation would not mean a uniform "stabilization" of prices. On the contrary, the prices of some goods would be bound to fall; and the producers of these goods would start protesting. A halt in inflation would reveal, also, that the optimistic illusions which inflation breeds have resulted in the misdirection of investment into industries whose facilities

have become relatively overexpanded. These industries would want inflation continued for their special benefit.

The Eisenhower Administration, in brief, must count the political cost of disinflation in advance, and be ready to pay it. And the rest of us must have the understanding to support it in that determination. ❁

## The Meaning of Savings

March 9, 1953

Dozens of different figures are now compiled, officially and unofficially, which purport to represent our personal or national "savings." A day seldom passes without some discussion of these figures in editorials, speeches or business forecasts. A frequent conclusion is that these savings present "unused purchasing power" which could "cushion" a slump. This conclusion is dubious and so are the figures themselves. There are astonishing discrepancies in the estimates, partly because of differences in concept and definition of savings, and partly because of different ways of estimating their amount. The Council of Economic Advisers, on the basis of the Department of Commerce figures, estimates that net personal saving amounted to some \$18,800,000,000 for 1952. The Securities and Exchange Commission, on the other hand, estimates that for the third quarter of 1952 total *gross* savings of individuals were running at an annual rate of \$15,000,000,000 (compared with a Department of Commerce estimate of a rate of \$20,300,000,000 for *net* personal saving in the same period). The *annual rate* of saving must not be confused with *cumulative* savings, which in turn must not be confused with *liquid assets*. Even if the layman can keep all these distinctions in mind, he may doubt how much better off he is. He looks up the latest figure of total deposits in savings banks, and finds it to be \$22,300,000,000. In addition there are \$2,600,000,000 in the postal savings system. He also finds that there are \$40,000,000,000 in time deposits in commercial banks. Should he include these in savings? If so, why not add also the \$99,400,000,000 in demand deposits in the commercial banks. Surely they are the depositors' "savings"! And why not go on to the value of life-insurance reserves, the assets of savings and loan associations and of government pension and trust funds, the value of government bonds, and corporation bonds and stocks?

But what the layman has been adding up, the statisticians will now tell him, is the value of "liquid assets." And he will get different totals for these depending on whether he consults the Federal Reserve Board or

the Securities and Exchange Commission. Last year the SEC estimated that at the end of 1951 individuals had accumulated a total of \$340,000,000,000 in liquid assets. This specifically did not include corporate securities, which would have raised the figure by \$210,000,000,000 more. But this total would come close to equaling the estimates of national wealth! After the layman has collected such figures and (if possible) reconciled them with each other, what practical or predictive use can he make of them? Do savings, for example, provide a “cushion” against depression?

The first thing the layman is forced to recognize is that a “liquid asset” for the individual is not necessarily a liquid asset for the community as a whole. One man’s quick asset is usually somebody else’s quick liability. Considered individually, people have available savings. But collectively they cannot spend their savings—for the simple reason that these have already been spent.

When a man puts \$1,000 in a savings-bank deposit, for example, the savings bank buys, say, a newly issued \$1,000 bond with it, and the corporation that sells it the bond buys, say, a \$1,000 machine tool with the proceeds. The depositor’s \$1,000 has been spent on a machine tool. If the depositor later withdraws his \$1,000 to spend it on consumption, the savings bank (in the absence of some offsetting deposit) has to sell its bond to someone else. But if this someone else buys the bond, he cannot then spend the same \$1,000 on his own consumption. His new saving must compensate for the former depositor’s “dissaving.”

The only way in which savers can collectively spend their savings (except to the small extent that these have consisted merely in hoarded cash) is through new borrowing, direct or indirect, at the banks, against their securities or other assets as collateral. But this means that new money must come into existence. And this is a form of inflation. ❁

## Stalin and Our Policy

March 16, 1953

The death of Stalin opened up wide possibilities. The most hopeful, (made unlikely by the quick appointment of Malenkov) was that it might have the same sort of dramatic sequel as the death of the Mongol Khan Ogdaï in 1241. That sequel has been vividly described by Winston Churchill: “The chivalry and armed power of Europe was completely shattered by the Asiatic hordes. . . . It seemed that nothing could avert doom. . . . But at the critical moment something happened—the Great Khan died. The succession was

vacant and the Mongol armies and their leaders trooped back on their ponies across the 7,000 miles which separated them from their capital in order to choose a successor. They never returned till now.”

The worst possibility is that Malenkov or those around him may decide that the best way to consolidate their power at home is to launch immediate aggressions abroad and to call for more “unity and vigilance.”

The probabilities, however, are favorable. History and the nature of the Russian despotism justify the hope that the would-be successors of Stalin, like the potential successors of Lenin and Caesar, will intrigue or war against each other.

But the consequences of Stalin’s death may depend much more on what *we* do about it than on what immediately happens in Russia itself. We have a tremendous opportunity. Much depends on whether we know how to exploit it.

We have missed almost every such opportunity in the past. By officially recognizing Stalin’s despotism we lost far more than we gained. In the war against Germany we had one opportunity after another to impose terms and conditions on Stalin, or to extract concessions or guarantees from him in return for the immense aid we were supplying. We missed them all. We continued to act as if we were mainly dependent on Stalin when he was mainly dependent on us. We bribed him to get into the Japanese war when there was no need for such a bribe. We surrendered more principles to get him into the United Nations, when we should have done far better to keep him out. The one real act of the United Nations against aggression—in Korea—was possible only because Stalinist Russia had made the mistake of a temporary walkout.

If Stalin is gone, the Communist ideology remains. Our chief task is still to know how to combat it. Neither the Roosevelt nor the Truman Administrations gave any evidence that they knew how. They not only tried to appease Russia, but they showed constant sympathy for anticapitalistic ideas and measures both abroad and at home. At home they encouraged monetary inflation, which is the kind of heady stimulant that undermines and can eventually destroy private enterprise and the free market. Truman in effect supported Iran in its breach of contract with the Anglo-Iranian Oil Co. and its seizure of the properties. He openly espoused the socialist “principle of nationalization.” He even offered American aid to Mossadegh, the weeping, pajama-clad dictator, to help him finance the oil seizure.

Our policies in recent years have rather consistently encouraged such foreign “nationalization”—i.e.,

expropriation with inadequate compensation or none at all. Our representatives abroad have encouraged and even demanded so-called “land reforms” that violate all the principles of private property, demoralize production, and are hardly distinguishable from Communist land seizures.

In brief, the ideology fashionable in Washington and Europe in the last twenty years has favored the doctrine that the way to combat Communism is to compromise with it or to imitate it. If this doctrine persists, even the present opportunity may be lost. We can combat the ideology of Communism only with the ideology of freedom. Right principles will dictate right policies and right tactics vis-à-vis the Communist menace. President Eisenhower, unbound by the ideology of his last two predecessors, has a golden chance to use the death of Stalin to restore hope and peace and honor in the world. ❁

## Trade, Plus Aid

March 23, 1953

It was in Britain and in Europe, and not here, that the catchy slogan originated: “Trade, Not Aid.” The implication of this was that the countries of Europe no longer were asking for subsidies and handouts. All they were asking for was that the United States remove the artificial barriers that it had put in the way of receiving imports. They would do the same, and then they would balance their foreign trade through their own efforts.

But in practice European officials have been giving an appallingly one-sided interpretation to their own slogan. It turns out to mean more demands on us without corresponding concessions. Some of their demands are entirely justified. They ask that we simplify our customs procedures, that we abolish any quota limitations on imports from them, and that we lower our tariffs still further. We should do all these things. They are as much in the interest of the American consumer as of the European producer.

But the *quid-pro-quo*s that European officials offer are virtually non-existent. They usually fail to suggest any reciprocal lowering of their own tariffs. Even when they do, they make such a reduction worse than meaningless by proposing to continue quotas and discriminations against American goods, and to continue bilateralism, special license requirements for imports, price-pegging for their own currencies, and rationing of

dollars. Moreover, their “Trade, Not Aid” slogan turns out to mean, after all, “Trade, *Plus* Aid.”

All this was illustrated in the series of talks just completed between British and American officials on the problem of convertibility of the pound. The British officials seem to assume that to make the pound convertible would be primarily a favor to the United States, and that therefore we should be willing to pay them to do it. What they appear to have in mind is that we put up some \$2,000,000,000 to \$4,000,000,000 as a stabilization fund to support the pound. Of course as long as we stood ready to pay over \$2.80 to anyone who wanted to convert a pound into dollars we could make the pound “convertible” at that rate as long as our money held out. But at the end of that time we would be just where we were at the start (except for our \$4,000,000,000) and the problem would remain unsolved.

The blunt truth is that “convertibility” of the pound is not a problem that even British officials (let alone ours) have to solve. All that British bureaucrats have to do is to *stop preventing* its convertibility. The British pound is pegged at \$2.80 *by law*. Except under specified conditions, it is made inconvertible into dollars *by law*. All the British bureaucrats have to do is to repeal these prohibitions. Then currency convertibility will take care of itself, as it has from time immemorial.

Two unwarranted fears have hitherto prevented this simple solution. The first is that the pound will sink and keep sinking. It will do so only if the British Government follows policies that undermine confidence in the pound. But if it keeps the discount rate high, if it keeps the paper pound scarce, if it keeps its budget balanced, if it turns its back firmly against threats of further socialism and property seizure, it will find such a fear groundless, as Canada did when it freed its own dollar.

The second fear is a “flight of capital.” This also is groundless unless government policy provokes such a flight. As an extra safeguard, the government could adopt, as a transitional measure, the device used by Peru. That country, although it forced its exporters to turn the dollars they had earned over to the government, gave them equivalent dollar “certificates” in exchange which they in turn were allowed to sell within Peru for whatever price (in soles) they could get in a free market from would-be importers. Thus there was at least free convertibility within national borders.

It is primarily to Britain’s advantage, rather than to ours, to make its currency convertible. If the will exists, the techniques of doing it present no serious problem. ❁



## A Tale about Taxes

March 30, 1953

The other day I met a friend who is a large stockholder in General Motors, and he told me a story. A few weeks before, his son had used somewhat excessive strength on the mixing valve in his bathroom and broke the handle off. The local plumber couldn't repair it, so he ordered and installed a new valve. The valve turned out to cost \$22.50. The installation, at \$4 an hour, brought the total up to \$100.

That sounded steep enough; but it was not until my friend had made some mental calculations that he realized how steep it really was. His income falls into the 90 percent tax bracket. So he figured that in order to acquire the \$100 with which to pay this plumber's bill, he had to receive \$1,000 in dividends from General Motors. (For the benefit of the non-mathematical, \$1,000 in dividends minus \$900 in taxes on them leaves \$100 to pay a plumber's bill.)

But this is only the beginning. In order to pay \$1,000 in dividends, General Motors has to earn more than \$4,000 before taxes. (General Motors earned \$1,502,000,000 before payment of taxes in 1952. It had to pay \$943,000,000 in taxes, leaving it \$559,000,000 in net income, out of which it paid \$362,000,000 in dividends. So for every \$1,000 it paid out in dividends, it had to earn \$4,149 before taxes.)

But in order to earn \$4,149 before taxes, General Motors had to sell \$21,570 worth of cars—say eighteen Chevrolets—to its dealers. (GM total sales and income in 1952 amounted to \$7,645,000,000.) To sum up, because of cost and tax erosion, in order for my stockholding friend to replace a bathroom valve, General Motors had to make and sell eighteen Chevrolets.

"So what?" some reader may ask. "If this fellow pays a 90 percent income tax, he must be rolling in it. Don't expect me to weep."

The point of the story is not that anyone should stop to weep, but that a few of us should stop to think. The question is not what our incredible burden of taxation is doing to this rich individual or that, but what effect is going to have in the long run on our whole economy—on productivity, wages, and employment.

Obviously a continuation of this rate and kind of taxation must undermine incentives, discourage new business ventures, and even prevent the formation of new capital for such ventures. For every dollar that General Motors paid to stockholders last year, it had to pay \$3 to the government (not counting what it collected and paid in excise and sales taxes). The case of General Motors, in this respect, is not exceptional.

The Department of Commerce estimates that corporate profits before taxes in 1952 were \$39,700,000,000; that out of this the corporations had to pay \$22,600,000,000 in taxes, and that they paid out \$9,100,000,000 in dividends. In other words, the government took an average of 57 percent of all the earnings of the corporations. And for every dollar that the corporate stockholders got in dividends, the government got \$2.48.

Even this does not tell us what the stockholders were able to *keep* in dividends after paying personal income taxes. A stockholder whose income gets into the top tax bracket of 92 percent can keep only 8 cents out of each dollar of dividends. The government gets the other 92 cents. Adding this to the \$2.48 that it has already taken from the corporation gives the government \$3.40. In other words, the government gets 42 times as much out of the average corporation as the investor in the top income-tax bracket is allowed to get and keep.

This may seem like a wonderful racket for the government while it lasts. But Congress should not be entirely astonished if it wakes up one day to discover—we hope not too late—that this division of the profits does not furnish the highest incentives for private investment in new enterprises; and that new venture capital has been drying up, with unpleasant effects on wages, employment, and production, and even on government revenues themselves. If we do not want to repeat the present predicament of England, we should not imitate the policies that brought her to it. ☸

## No Stand-By Controls

April 6, 1953

No sooner have we got rid of the self-imposed incubus of price control than agitation has begun for setting up stand-by wage- and price-control powers to take effect immediately should we ever get into a third world war. The proposal is unsound both economically and politically.

Senator Capehart of Indiana has taken the leadership in pressing for this legislation. He has been supported by the testimony of Bernard M. Baruch. It was Baruch's testimony in the summer of 1950, in favor of "an overall ceiling across the entire economy," that was chiefly responsible for the subsequent enactment of price-control legislation. Baruch's prestige in many fields is richly deserved. But his price-fixing proposals disregard the most elementary economic facts and principles.

In 1950 he proposed that all prices and wages be "rolled back" to and frozen as of June 25, the day



hostilities broke out. Now he is supporting the Capehart plan for an across-the-board, 90-day freeze of prices and wages in an all-out war. He has even urged that such a freeze should be extended to a year.

Of all forms of price control, an overall freeze is the most unworkable and the most harmful. To provide that in the event of a total war prices and wages must be absolutely frozen is like providing that in the event of a theater fire everybody must be strapped to his seat to avoid disorder.

Baruch often refers to our control experience in the first world war. The late Benjamin M. Anderson, in his book, *Economics and the Public Welfare* (1949), pointed out: "Wages we did not try to fix in World War I. . . . Price fixing we engaged in cautiously. There was . . . recognition of economic fundamentals. Prices have work to do. Prices have the important function of accomplishing priorities, allocations, and rationing. . . . It is the work of free prices and freely moving wages to determine whether labor and supplies shall be drawn to the production of commodity 'A' or of commodity 'B.' Rising prices mean more production. Falling prices mean less production. . . . With freely moving prices and freely moving wages, the goods in most urgent demand are produced, and the production of the less urgently demanded goods declines. Price fixing by itself tends to derange perversely the control of production and consumption."

At the outbreak of total war, what is desperately urgent is the quickest possible change-over from civilian output to military output. It is precisely this that a blanket price-and-wage freeze would prevent or delay.

And how would a blanket-freeze formula be applied? To wages, for example? If we froze weekly wages we would discourage or prevent overtime work, just when such work was most essential. If we froze hourly rates, but allowed the customary 50 percent overtime premium, we would immediately get more overtime in the production of military goods. But this would raise the unit labor cost of such goods. If we did not allow the price of these goods to go up, we would discourage or prevent their production. If we did allow the price of these goods to go up, the blanket-freeze formula would already be breached. (An overall wage freeze would, of course, also prevent the producers of military goods from offering higher wages to attract labor away from the production of civilian goods. This would necessitate government direction of labor—i.e., telling each worker what job he must take.)

On Jan. 26, 1951, our price controllers actually announced a so-called overall price-and-wage freeze. The very next day an executive of the Office of Price Stabilization said that his agency was working intensely

to "cure the absurdities and inequities inherent in such a sweeping order." In total war we may need quick priorities and rationing—but these work best without price controls.

If the government follows proper fiscal and monetary policies in a total war it will not need price control. If it follows inflationary fiscal and monetary policies, price control will be not only futile but pernicious. ❁

## Inflation Must Have a Stop

April 13, 1953

In recent weeks there have been signs of a recession. Wholesale prices, of course, have been sliding since they reached a peak of 116.5 in February-March 1951. By March 10 the price of steers dropped nearly 30 percent from the beginning of this year. Though the Office of Price Stabilization removed the last price ceilings on March 17, the decontrol has had no important effect on the average level of wholesale prices. The official index, in fact, dropped slightly to 110 in the week ended March 24. At the end of March, the Dow-Jones spot commodity price index stood at 168; a year previous it was 192. Chrysler announced automobile price cuts on March 25. On March 30 the stock market suffered the worst break since Oct. 22, 1951.

The stock-market break was generally attributed to the latest Korean peace overtures. Now if we take these seriously, they might adversely affect the price of securities in two ways. Some corporations are heavily dependent on direct war orders. If these declined, they might not find it easy to replace them. A drop in defense spending, moreover, could mean an end to inflation. Commodity and stock prices based on the assumption of continued monetary inflation would fall.

It would be absurd, however, to rush from this to the conclusion that a truce in Korea, or a lessening of the threat of a third world war, would be bad for our economy in general. Such a conclusion assumes that the best thing for business, employment, and the well-being of consumers would be the continued wasteful production of arms and ammunition.

This is merely a special case of the ridiculous reasoning which assumes that prosperity depends on the volume of government spending. What this reasoning overlooks is that the less the government must spend on armament or anything else the more it can reduce taxes. Then people can spend more of their own money for the things *they* want rather than have it seized by the government to be spent on the things *it* wants.

"War prosperity" is produced not by the volume of defense spending but by the inflationary method

of financing it. It is produced, in other words, by an increase in the supply of money and bank credit. As the present inflationary boom shows signs of slackening off (which it did long before the latest Korean truce overtures) there will be increasing pressure on the Eisenhower Administration to resume inflation in one form or another. The increased pressure for more and higher farm price supports is a mere foretaste.

Willingness to accept some adjustment and recession now will be a test of the sincerity of all those who have been affecting to deplore inflation. More important, it will be a test of their understanding. It is true that the present inflationary boom could be kept going for a time by further doses of inflation. But to inject these now would be to build up for an inevitable crisis and collapse.

In an article in the Feb. 19 issue of *The Commercial and Financial Chronicle*, the economist L. Albert Hahn drew a striking parallel between the present inflation as it has developed since the autumn of 1949, and a previous "second postwar boom"—from 1921 to 1929. Both booms, he pointed out, rested on money and credit inflation. Between the end of 1948 and today total loans and investments of the commercial banks have been increased from \$114,000,000,000 to \$140,000,000,000. This compares with a rise from about \$38,000,000,000 in 1921 to \$50,000,000,000 in 1929.

Wholesale prices in the present period have increased (even after their recent decline) by roughly 12 percent. Wholesale prices between 1921 and 1929 actually showed a slight decline, *in spite of monetary inflation*. This led to the false belief that there was no inflation; and warning signals were ignored. Hahn argues that a monetary and credit inflation without a price rise ("inflation without inflation") can be as dangerous as any other. To prevent a future depression, he advises, we must put "brakes on the [present] boom before it enters its excessive phase." ❁

## Would Peace Be a Disaster?

April 20, 1953

I predicted in this place last week that fears of peace in Korea would lead to "increasing pressure on the Eisenhower Administration to resume inflation in one form or another." Typical of the comment already appearing is a dispatch in *The New York Times* of April 8 from James Reston.

"The Soviet 'peace offensive,'" it begins, "has had at least one good influence [in Washington]. It has alerted the government planners whose job it is . . . to

make provision for the day when defense spending will not assure full employment. . . . For seven years the Russians have tried to scare us into isolation and inflation; now, as the experts here see it, one of their objectives seems to be to smile us into disarmament, deflation, unemployment, and depression. . . . Labor union leaders . . . already have started appealing to the President to plan at once for the day when the vast government orders for munitions will drop off. . . . The observers think that . . . the Soviet hierarchy is trying to bring the United States up against the major problem of keeping its people employed when it shifts to a modified peace economy."

Notice how the dispatch rolls "disarmament, deflation, unemployment, and depression" all into one package, implying that the first necessarily involves the last. Notice the implied labor-union-leader plea to maintain the present fantastic rate of government spending at all hazards.

It was only a few months ago that the Russian Communists were accused of threatening war mainly to force us to spend ourselves into inflation and bankruptcy. Now they are accused of threatening peace to force us to economize ourselves into unemployment and depression. A regular technique seems to have developed among our would-be planners, official and unofficial. If they want to get us to do something, they immediately charge that the Russian Communists are trying to force us to do the opposite.

"In the Soviet mind," *The Times* dispatch continues, "the capitalist world cannot close the gap between its production and consumption without vast expenditures for war." Whether or not this is the Soviet theory, it is certainly the theory of most of our home-grown planners. They might admit, perhaps, that we don't need vast expenditures for *war*. But we certainly, in their opinion, need vast government expenditures for *something* if we are to "close the gap between production and consumption."

As this column has often pointed out, this theory is pure Keynesian nonsense. It is astounding that it could have survived the experience immediately after Japan surrendered in August 1945, when a sweeping cancellation of war contracts was followed by even higher employment in the spring of 1946. How often must it be pointed out that if the government spends, say, \$10,000,000,000 a year less on defense, the taxpayers have \$10,000,000,000 more of their own money to spend on themselves?

What the planners and "experts" in *The Times* dispatch are really arguing for is the continuance of monetary inflation. Indeed, a school is now developing

that openly embraces Perpetual Inflation. Listen to Prof. Seymour Harris of Harvard. Perhaps the present Administration's monetary authorities, he writes in a letter to *The New York Times* of April 5, "will tell us where, in the absence of bank purchases [of government bonds], the money is to come from which will be required over the next 25 years on the conservative assumption that real income would rise by 100 percent and prices by only 50 percent. . . . For when the banks buy, additional deposits are created."

In other words, Harris insists that even if production of commodities doubles, their prices ought to be raised by at least 50 percent. This result could only be brought about, of course, by an enormous further inflation (of some 200 percent) in the money supply.

With such doctrines on the loose, the Administration is going to find it extremely difficult to hold to a course of economic, fiscal, and monetary sanity. ❁

## Inflation without Tears?

April 27, 1953

A book just published, *Money, Men and Machines*, by Waddill Catchings and Charles F. Roos (Duell, Sloan & Pearce-Little, Brown, \$2.50), attempts to supply a new answer to the problem of how to avoid both "inflation" and "deflation" and still keep continuous full employment.

Catchings is chiefly known as co-author with William T. Foster of *Money* (1923) and *Profits* (1925). Roos was director of research for the NRA and is now president of the Econometric Institute in New York. Their book is short, lucid, handsomely printed, and extremely readable. It contains, among other merits, a well-reasoned argument for economic freedom and an excellent description of the workings of what the authors call the "price-and-profit mechanism" in our system of private competitive enterprise.

But the answer that the book offers to the problems of "monetary management" is vague and disappointing. The authors are opposed both to the orthodox solutions of the past and practices of the present. They accuse the Federal Reserve Banks of "mismanagement of our money supply" in 1929, in 1937, and in 1948–49. They don't like what they call the Reserve Board's "zigzag methods of monetary manipulation," by which they mean the lowering and raising (especially the raising) of discount rates.

They speak constantly of the dangers of a "dear-money policy" but never define "dear" money.

"Throughout much of 1951 and 1952," they write (p. 109), "the Federal Reserve System pursued a dear-money policy. The result was that the long-term interest rate rose by more than 10 percent, and the short-term rate by more than 50 percent." These increases, calculated in this way, sound startling. But the authors neglect to tell us that even after this "dear-money" policy the average interest rate on four-to-six months' prime commercial paper in 1952 was only 2.33 percent, and on three-month Treasury bills only 1.76 percent. On the best-grade corporate bonds the average yield in 1952 was 2.96 percent—as compared with an average yield of 5.07 percent, for example, in the ten years from 1920 to 1929 inclusive. If the short- and long-term interest rates of 1952 represented "dear" money, it would be interesting to know what the authors' idea is of really cheap money.

Their own proposals, as I have said, are vague. The Federal Reserve Board is to be "directed to provide a supply of money that is adequate but not excessive." This is not a solution, but merely a statement of the problem, which is precisely how to determine what money supply is "adequate" and what is "excessive." "It is only necessary for Congress to declare that the purpose of managing money is to provide the people with the amount they need to produce according to their ability and desire." This is just as nebulous.

Catchings and Roos don't like the international gold standard: It "sacrificed domestic prosperity for the stability of foreign exchange." And instead of control of the money supply through changes in the discount rate, they prefer the clumsier method of changing reserve requirements. But they do not consider what the effect of this would be on interest rates, nor do they tell us whether they would try to change reserves or reserve requirements while forbidding consequent changes in interest rates.

In short, the reasoning of the authors, on their central proposal, is confused. By an "adequate" supply of money, they obviously don't mean an unchanged supply. "To be adequate, our money must increase regularly from year to year." The wage-price spiral, they correctly tell us in italics on page 90, exists "*only because the Reserve Board allows the money supply to increase.*" But on page 101 we learn that if a wage-price spiral does start, we must provide more money to sustain it.

The basic proposals of *Money, Men and Machines* would be inflationary in effect. If we intend to halt inflation, we must begin by allowing interest rates to rise. And eventually we must return to a real gold standard. ❁



## To Restore Budget Control

May 4, 1953

Congress has allowed its Constitutional power of the purse to slip through its fingers. As Roswell Magill, former Under Secretary of the Treasury, recently testified: "Congress has lost annual control of expenditures." He pointed out that \$53,000,000,000 of the \$78,600,000,000 expenditures proposed for the fiscal year 1954 is "not subject to control or review" by Congress this year. "Even if Congress failed to appropriate a dime during this session, the agencies and departments of the Federal government would have available for expenditures on June 30, 1953, more than \$100,000,000,000 of unexpended balances from previous authorizations."

As a first step to cure this situation, and to stop the deficits that the Federal government has incurred in twenty out of the last 23 years, Representative Coudert of New York has introduced a bill (H.R. 2) to provide that Federal expenditures shall not exceed revenues except in time of war or grave national emergency.

The bill provides, in other words, that there shall be no more deficit financing and no more resort to printing-press money, except upon at least a two-thirds vote of each house and a resolution declaring a national emergency. Such a measure would put a statutory limit on spending. It would tie spending directly to tax revenues. It would enable Congress to reassert its power of the purse and regain annual fiscal control.

The Coudert bill has the support of several governors and of the Conference of State Taxpayer Executives representing 38 state taxpayer associations. One of the witnesses in its favor was Governor Herter of Massachusetts. "Ten years spent here in Congress," he said, "taught me one lesson so well, and gave me one warning so imperatively, that I shall not forget either. The lesson was that unless Congress maintains rigid control over the spending agencies of the Federal government we may one day find ourselves facing a national crisis of the first magnitude; and the warning was that Congress has lost such control. I believe that nothing more important can be done at this session than to regain it and thus establish national solvency."

Governor Herter also reminded Congress that the procedure prescribed by the Coudert bill is essentially no different from the one which already exists in many states, including his own. "As governor, it is my Constitutional duty to submit [an annual] budget . . . and at the same time to submit a schedule of revenues to balance what I propose to spend. . . . The legislature may thereafter increase appropriations beyond

my recommendations, but it may not be adjourned until it has provided the revenues to pay for what it appropriates."

I am sorry to report that the new Secretary of the Treasury and the new Director of the Budget, while endorsing the aims of the Coudert bill, opposed the procedure it prescribed as too "inflexible." This objection is without substance. The most flexible spending control that Congress can exercise (without actually abdicating its Constitutional responsibilities) is to set an overall ceiling on expenditures and allow the executive branch a very wide latitude in proposing whatever budgetary allocation of detailed expenditures it deems wise *within that overall total*. This is the way every individual business firm and every individual household is compelled to operate. Its total expenditures must be kept within its total income. If this is a "strait jacket," it is a desperately needed one.

Nothing, certainly, could be more unrealistic than the procedure so often recommended—that "Congress should vigorously pare down spending, bill by bill and item by item." A Federal budget of \$78,000,000,000 is made up not merely of thousands, but of hundreds of thousands of individual items. No assembly of 531 men can possibly have the time and the knowledge to consider the merits of each item. But it can and does know that a chronically unbalanced budget and an intolerable burden of taxation can lead us to disaster. ☸

## Repeal the Taft-Hartley Act

May 11, 1953

It has remained for John L. Lewis to make the most sensible suggestion of any witness before the Senate Labor Committee on what to do about the Taft-Hartley Act: "Since management has cried out so sorely against the Wagner Act and all the manifold injustices alleged to be contained therein, let them now join us in repealing the Taft-Hartley Act in toto, lock, stock, and barrel, including the Wagner Act itself, upon which Taft-Hartley is founded. This would give to this country, its employers and employees, an opportunity . . . to practice for a season true, free, and genuine collective bargaining without governmental interference. . . . Leave the Norris-La Guardia and the Clayton Acts as the Federal rule and guide in the field of labor-management relations. . . ."

Most of us, including Senator Taft and a multitude of business groups, have forgotten that the Taft-Hartley Act is merely an amended Wagner Act, and retains most of the unsound principles embodied in the parent law. The Wagner Act abridged the freedom of



the employer to hire or discharge, negotiate or bargain. It abridged his freedom to employ associates of his own choosing. He was forced to deal with the particular unions certified by a government board, no matter how unreasonable their demands or how unsatisfactory their performance. The union leaders were, it is true, certified through an "election," but the Labor Board decided what unions it would allow on the ballot, and it could gerrymander the "appropriate" bargaining units pretty much to suit itself.

The Wagner Act in effect turned the government into a union-organizing agency. The frankly avowed purpose of its sponsors was to increase the power of unions. Its way of seeking "to diminish the causes of labor disputes" was to encourage strikes by granting strikers immunity from discharge, and often even holding out the promise of back pay after a strike.

The act was openly one-sided. The only "unfair" acts it forbade were acts of employers. The employer could not "refuse to bargain collectively" with his employees (an extremely vague requirement never satisfactorily defined). There was nothing in the act, however, to prevent even the government-certified union from refusing to bargain with the employer. The certified-union leaders became government-certified monopolists. The law in effect authorized unions to paralyze the economic life of the country or dictate the terms on which they would refrain from doing so.

The Taft-Hartley Act retained most of the abridgments in the Wagner Act on the bargaining freedom of employers, but sought a semblance of balance by trying to impose a few curbs on union leaders. Therefore most union leaders have denounced it as a "slave labor" act. Yet a good deal of the one-sidedness and hypocrisy of the Wagner Act has been retained in Taft-Hartley. In its one pretense of balance, the Wagner Act declared it to be an unfair practice for an employer either to "encourage or discourage membership in any labor organization." The "discourage" was interpreted with a severity that infringed the employer's very freedom of speech. But the Wagner Act at another point specifically authorized a closed shop—i.e., it authorized the employer to discriminate totally against nonunion members. And the Taft-Hartley Act specifically authorizes a "union shop" under which the employer must fire anyone who does not join a union 30 days after his employment.

The effort, in brief, to "balance" abridgments of the bargaining freedom of employers with allegedly corresponding restrictions on union leaders has worked badly. It has led to increased governmental meddling with individual and collective bargaining. This meddling

has created, exacerbated, and prolonged far more labor strife and strikes than it has prevented. Last year's steel strike is an outstanding example.

Why not, as John L. Lewis suggests, try the pre-New Deal labor-law situation for a while? ❁

## No End to Superspending?

May 18, 1953

The announcement of President Eisenhower on April 30 that he would ask Congress "to appropriate \$8,500,000,000 less new money for fiscal year 1954 than had been asked for by the previous Administration" made a good one-day headline. But it will not bring much comfort to taxpayers who examine the situation closely. This \$8,500,000,000 is not a proposed cut compared with the previous rate of Truman spending. It is merely a cut from President Truman's *estimate* for a fiscal year when he would not be in office and for which he knew he could not be held responsible. And it is a cut only in requested new appropriations, not necessarily a cut in actual rate of spending. In last week's issue, *Newsweek* estimated that the Eisenhower spending budget for the fiscal year 1954 would approximate \$74,200,000,000. This would be about the same as is being spent in the present Truman-Eisenhower fiscal year which ends on June 30. But it would be \$8,000,000,000 *more* than was actually spent in the last full Truman fiscal year of 1952 and almost \$30,000,000,000 more than was spent in the Truman fiscal year 1951. The Korean war was being fought during the whole of both these years.

Mr. Eisenhower complains that when he took office he found "a total carry-over of \$81,000,000,000 in appropriated funds, largely committed. . . . It's just as if the late Administration had gone to the store and ordered \$81,000,000,000 of goods, which we've got to pay for as they're delivered, in addition to paying the regular household running expenses."

But two questions must be raised about this: (1) Is the whole of this \$81,000,000,000 in fact so irrevocably committed (in the form of noncancelable contracts, for instance) that no appreciable part of it can either be rescinded or used for new purposes? (2) Isn't Mr. Eisenhower planning to continue the same sort of carry-over to make it just as difficult to balance the budget in future years? A simple calculation leads, in fact, to the conclusion that on his present proposed spending and appropriation program he will end even the fiscal year

1954 with a carry-over of more than \$70,000,000,000 unspent appropriations into 1955.

"I have always firmly believed," said Mr. Eisenhower in his statement of April 30, "that there is a great logic in the conduct of military affairs. There is an equally great logic in economic affairs. . . . If . . . these two are allowed to proceed in disregard one for the other, you then create a situation either of doubtful military strength or of such precarious economic strength that your military position is in constant jeopardy."

This is admirably said. But the specific budget decisions Mr. Eisenhower has so far announced seem in fact to disregard economic logic. His message of May 5, urging Congress to authorize \$5,800,000,000 for the foreign-aid program in the fiscal year 1954, is an outstanding case in point. True, this was a reduction of about \$1,800,000,000 from the previous Administration's 1954 budget. But Mr. Eisenhower is asking for it *on top of* some \$9,000,000,000 of prior appropriations for foreign aid that still remain unspent at this time.

Nor did the statements either of Mr. Eisenhower or Mr. Dulles really explain why this additional \$5,800,000,000 is needed. It is not enough merely to contend that the United States must "carry out its responsibilities of leadership in building up the security of the free world." It must be shown that this particular method is the way to do this, and that no less than this amount is necessary. The answers to these questions so far have been little better than rhetorical. Our whole foreign-military-aid program, in fact, rests on the constantly reiterated but still unproved contention that Europe cannot afford to pay for its own defense.

Our own economy is in real danger from the present appalling rate of spending and intolerable load of taxes. If it is undermined by these the defense of the whole free world will really be imperiled. ❀

## Asking for More Inflation

May 25, 1953

In the issue of March 2, I wrote here: "We shall soon learn whether the American people really want to halt inflation, and whether they are willing to pay the price." The answer so far has not been reassuring.

Let's begin with the budget. The burden of taxation is already as high as the American economy can possibly stand. Inflation can be halted only by a slash in the present fantastic level of Federal expenditures large

enough to wipe out our chronic deficits. One would not suppose such a slash to be supremely difficult. The \$73,700,000,000 that we are spending in the current fiscal year alone is more than Franklin D. Roosevelt spent in the full eight years of his first two terms. It is nearly \$30,000,000,000 more than even Harry Truman spent in the fiscal year 1951, during the whole of which the war in Korea was in progress.

It was less than a year ago that Mr. Eisenhower himself ventured the opinion that the Federal budget could be cut as much as \$40,000,000,000 in the next few years. But when he recently announced reductions that would still keep spending in the 1954 fiscal year at a level of \$73,500,000,000 (according to the Stam estimates for Congress), there was a chorus of outcries that these economies would imperil the country.

Now it is always possible, even in a budget of these incredibly swollen overall dimensions, to "economize" in the wrong place, to cut down on the wrong thing—on long-range air power, let us say. But what is disheartening is that so few of the critics of specific cuts bother to suggest where the cuts might be made instead. Even on the present program, according to the Stam estimates, there will be a deficit in the current fiscal year of more than \$7,000,000,000, and in the next fiscal year of nearly \$6,000,000,000. But this is being treated as if it were a matter of no particular concern.

Even more ominous, so far as the outlook for a halt in inflation is concerned, is the attitude being taken both inside and outside Congress toward the efforts of our monetary authorities finally to end the inflationary spree that has wiped out more than half of the purchasing power of the dollar since 1939. Twenty Democrats in Congress, including their leader in the House, Sam Rayburn, and their whip, John W. McCormack, have sponsored a resolution calling on the Federal Reserve Board to start supporting government bonds again at par. If they really understand what they are asking for, they ought to say outright: "We want more inflation."

Let us see what the course they demand would mean. At the moment of writing this, some of the government's 2½ percent bond issues are selling around 91 or 92. How many billions of dollars worth of bonds the Federal Reserve Banks would have to buy to bring these up to 100—and keep them there—is anybody's guess. The Reserve Banks would create deposit credits to "pay" for these bonds. These credits would then become the basis for several times as much new money and bank credit—in short, for inflation.

The action would increase not only the available supply of inflationary credit but the demand for it. In

fact, to order the Federal Reserve Banks to buy all government  $2\frac{1}{2}$  percent bonds offered to them at par is only another way of ordering them to increase the money and credit supply enough to keep long-term interest rates down to  $2\frac{1}{2}$  percent. And such low interest rates, thus artificially produced, encourage more private borrowing. This is the main explanation for the increase in the supply of bank deposits and currency from \$63,000,000,000 at the end of 1939 to \$192,000,000,000 at the end of this January.

Yet people are shouting about “dear money” and “deflation” when the discount rate is 2 percent and when, as W. Randolph Burgess of the Treasury has pointed out, unemployment is at a minimum, the index of production made a new record high in the latest reported month, and personal income has reached a new high rate of \$282,500,000,000 a year. ❁

## Spending Can Be Cut More

June 1, 1953

President Eisenhower’s radio talk of May 19 on the budget, and his tax message to Congress the next day, once more illustrated his deep honesty and earnestness in grappling with our major national problems. Yet his announced decisions, on net balance, must be set down as disappointing.

He is planning expenditures for the coming fiscal year of more than \$74,000,000,000. This would be higher than was spent in any fiscal year under Truman. It would leave an estimated deficit under present tax laws of \$6,600,000,000. Even if Mr. Eisenhower gets all the tax extensions he is recommending (and most of which are unwise), his proposed expenditures would still leave an estimated deficit of \$5,600,000,000.

Do expenditures of more than \$74,000,000,000 in 1954 in fact represent an irreducible minimum? Mr. Eisenhower himself has some admirable words to say in this connection: “Words like ‘essential’ and ‘indispensable’ and ‘absolute minimum’ . . . are spent with wild abandon.” Yet his actual spending budget is made up in large part of “absolute minimums” that turn out on examination to be very dubiously minimum. He seems to accept the whole \$81,000,000,000 of unspent appropriations from the Truman Administration as irreducible and noncancelable, and his own budget apparently contemplates carrying forward some \$70,000,000,000 of unspent authorizations into 1955.

Suppose we disregard the evidence of shocking waste in military expenditures uncovered in the last few years by Congressional committees, and accept all the military-spending estimates as irreducible. The budget still includes expenditures with worse than no economic justification. One need merely point for illustration to the billions spent and to be spent on farm-price supports which make food dearer for the American consumer.

The arguments for expenditure on a major item—the \$5,800,000,000 being asked as an additional appropriation for foreign aid—are still rhetorical rather than factual. This is illustrated by General Ridgway’s testimony before the Senate Foreign Relations Committee on May 19. He treated concern for economy with some contempt: “I don’t believe the civil authorities would want me to change my professional judgment as to the minimum requirements I believe necessary just because someone says it costs too much. . . . Money values assume somewhat different importance when all you hold dear is at stake.”

This perhaps misses the point that what we hold most dear may depend for protection just as much on our long-term economic strength as on our immediate military expenditures. The \$5,800,000,000 that the President and General Ridgway are asking for foreign aid in 1954 is about the size of the inflationary deficit we are planning for that year. It is fair to point out, therefore, that if this amount were not spent for foreign aid in 1954 we could either avoid the deficit entirely, or avoid the tax prolongations that Mr. Eisenhower himself admits to be unsound. (His judgment on the excess-profits tax is that it “actually penalizes thrift and efficiency and hampers business expansion.”)

The huge foreign-aid program is now costly to our own economic health. And it rests on the very dubious contention that Europe cannot afford to pay for its own defense. This is primarily an economic, not a military, contention; and General Ridgway is not a final authority on its soundness.

It is impossible, of course, to consider the budget without considering the wisdom of specific government policies and attempted functions. Even where it is agreed that the taxpayer’s money should be spent in a given direction, there is always the further question, *how much?* The present budget quandary once more suggests the need for drastic procedural reforms. Certainly a minimum first step would be the adoption of something like the Coudert resolution (see this column of May 4). We still have a budget system under which responsibility cannot be clearly fixed. ❁



## Unneeded Stand-By Controls

June 8, 1953

The original Capehart proposal to give the President power to impose a 90-day freeze on prices, wages, and rents in the event of a "grave national emergency" was so transformed as it emerged from the Senate that the House may not even consider it. This would be just as well.

Though the original proposal was approved by the Banking and Currency Committee by a vote of 12 to 3, the minority report ably summarized the objections to it: "It embodies stand-by control provisions for which the President did not ask. It embodies a philosophy counter to the views expressed by the President in his inaugural address. . . . If enacted into law, it would embed an economic fallacy into the functioning of the American economy for the life of the legislation."

The minority convincingly refuted the contention of the majority report that it was price controls which finally stabilized prices during the Korean war. "If controls were holding the prices from going higher, the wholesale price-index graph should show a horizontal line at ceiling levels. Instead it shows a sizable drop below ceiling levels. . . . Final removal of price and wage controls has resulted in no general or significant increase in either prices or wages despite the forecasts of alarmists."

It was the political and not the economic objections of the minority to the Capehart proposal, however, that were effective in securing changes in the Senate. The minority pointed out that under the original bill an overall freeze could be imposed "upon a simple finding that a 'grave national emergency' exists. . . . The bill would amount to a grant of power to invoke the freeze whenever bureaucratic advisers . . . could persuade the President to make the required finding." The Senate therefore revised the bill to require a concurrent resolution of the Senate and House to find that an emergency existed before the President could call for a freeze.

But it was because the Senate majority accepted the economic ideology of the bill's sponsors that it defeated the proposal of Senator Bricker to strike out all authority to impose a price-and-wage freeze. The Senate bill even requires the President automatically to freeze wages, prices, and rents if the United States declares war on a foreign nation.

All such price-and-wage freeze proposals rest on lack of economic understanding. It is significant that the long majority report never once mentions the huge increase in the supply of money and credit that took place after the outbreak of the Korean war. This was

the real cause of the price-and-wage rise, which could have been stopped at any time by proper fiscal and monetary measures. Instead the government encouraged the increase in the money and credit supply, and then "fought" the consequent inflation with price control.

The majority report's argument depends heavily on a false analogy. It speaks of "economic mobilization" for war. Like Bernard Baruch, it identifies such "mobilization" with a price-and-wage freeze. Now mobilization, in the military sense, means "to assemble . . . an army or a fleet." It certainly doesn't mean compelling everybody to stay just where he was before the war broke out. A price-and-wage freeze would be, in fact, the greatest *obstacle* to economic mobilization for war. Price changes are necessary to tell us the truth about comparative surpluses and shortages. They provide the incentives or deterrents that divert production most quickly into the lines where it is most needed. Free prices act faster than fumbling bureaucrats.

One element of sense in the "economic mobilization" idea is that it may be necessary, on the outbreak of a major war, for the government to put into effect some immediate priorities and allocations. But not only can all this be done without government price fixing; it can be done quicker and better without price fixing. When there are shortages, price ceilings make priorities and rationing *more* necessary, not less. Priorities and rationing, on the other hand, can in themselves restrain price rises. ❁

## Why Foreign Arms Aid?

June 15, 1953

For the fiscal year beginning July 1 we face an estimated deficit under present tax laws of \$6,600,000,000 and, even if Mr. Eisenhower gets all the tax extensions he wants, of \$5,600,000,000. We profess not to know how to solve this problem. Yet we are planning to give away \$6,500,000,000 to foreign countries.

Our foreign-aid program, once mainly "economic," is now mainly for "defense." Congressmen hesitate to criticize it because they think it involves primarily a "military" question. It still involves, in fact, primarily an economic question, for it rests on two invalid economic assumptions: (1) that Europe cannot afford to pay for its own defense and (2) that the amount we give for defense aid all goes to increase foreign defense.

Here are this fiscal year's armament expenditures of ten of our aid beneficiaries stated as a percentage of (1) their total central governmental expenditures (TGE)



and (2) their gross national product (GNP). The record of these European countries is compared with our own:

Defense Expenditures		
Country	% of TGE	% of GNP
Belgium-Luxembourg	23.6	6.3
Denmark	24.2	3.5
France	37.6	11.2
Greece	39.0	8.5
Italy	26.4	5.8
Netherlands	23.3	6.2
Norway	26.5	5.0
Portugal	35.5	5.0
Turkey	40.8	6.5
United Kingdom	37.2	12.0
United States	71.3	15.0

The United States, in brief, is spending on national defense more than four times as much *absolutely* as these ten nations combined (some \$53,200,000,000 against a total of \$11,800,000,000). It is also spending much more *relatively*—15 percent of its gross national product against an average of 7 percent for the ten beneficiaries.

Many Europeans argue that this is just as it should be. They advocate a sort of international progressive income tax. This rests on the theory that the man or country that produces more and earns more somehow owes the difference to the man or country that produces less and earns less.

Yet the United States, which is giving the defense aid, is spending some 70 percent of its total budget on defense, whereas the countries receiving the aid are spending on the average only some 30 percent of their total budget on defense. This is another way of saying that while we in the United States can afford to spend only 30 percent of our total budget on nondefense items, the European beneficiaries of arms aid are lavishly spending some 70 percent of their total budgets on nondefense items. They are robbing their own defense at the cost of comparative luxuries (including deficits on their nationalized industries).

This relationship cannot be excused on the plea of poverty. On the contrary. In the foregoing table it is Greece and Turkey that have the highest relative defense budgets. Yugoslavia devotes some 80 percent of its total spending budget to defense, and Nationalist China about 57 percent. The ten countries in the table spend altogether a modest \$11,800,000,000 on defense and some \$34,200,000,000 on nondefense. Suppose we

assume that we are contributing some \$4,200,000,000 a year to their defense. Why can't they, instead, take this out of their nondefense expenditures (which would still leave them some \$30,000,000,000 for this purpose) and add it to their defense expenditures (which would still be only about half of their nondefense expenditures)?

It is relevant here to point out that whatever money or material we give to a European government for defense aid, however specifically earmarked, can simply release that much of that country's own funds for additional nondefense expenditures. The only way we could make sure that this diversion is not taking place would be to dictate and supervise every item of that government's budget. And no one would dare propose such dictation. ⚙

## A Budget Out of Control

June 22, 1953

We are witnessing once more the sad spectacle that has repeated itself again and again over the last twenty years—the utter rout and defeat of the forces for economy.

President Eisenhower, who started off so bravely a year ago with the statement that the Federal budget could be cut as much as \$40,000,000,000 in the next few years, is planning to spend in the next fiscal year more than \$74,000,000,000—an amount higher than was spent in any fiscal year under Truman. Yet it is not these terrific expenditures that are receiving the brunt of criticism in Congress and in the press, but the one major economy proposed in the military budget. And nowhere else in the budget is a major cut even being seriously proposed.

That the forces of economy should have been routed in 1934, when Federal expenditures jumped to nearly \$7,000,000,000 and the debt to \$27,000,000,000, was deplorable enough. But that the forces of economy should be just as thoroughly routed in 1954, when Federal expenditures are to be \$74,000,000,000 and the Federal debt is scheduled to exceed \$270,000,000,000, is enormously more serious. If proposals for government economy are dismissed even more peremptorily today than they were twenty years ago—though the rate of Federal expenditures and the national debt have both increased tenfold—then there must be some persistent factor at work that calls for the most urgent analysis and correction.

That factor is not mysterious. It is the lack of anything approaching a responsible budget system. Even the accounting is so chaotic that no one seems to know where we stand. President Eisenhower has been complaining that he has no real control of the budget because of a carryover into the next fiscal year of some \$81,000,000,000 of funds appropriated and committed but not yet spent. He is treating this carryover as practically irreducible and nonre-scissible. Yet the Joint Congressional Committee on Reduction of Nonessential Federal Expenditures (the Byrd committee) pointed out in a recent report that some \$5,200,000,000 of this amount was in fact still uncommitted and unobligated. And it added: "Experience indicates the firmness of some of the so-called obligations may be subject to review." On the other hand, the committee includes not only this \$81,000,000,000 in its total of unexpended balances, but more than \$20,000,000,000 of "revolving and management funds"—bringing its own total estimate to \$102,000,000,000.

Our budget "system" is set up for the spenders, not for the economizers. Almost any of the reforms that have been suggested would do at least some good. This is particularly true of the Byrd proposal for a single annual appropriation bill, and of the Coudert proposal for keeping Federal expenditures within revenues except in time of war or grave national emergency (see this column of May 4).

But we will never have a responsible budget in this country until we have removed the chief reason for irresponsibility. This is the power of the House of Representatives to increase expenditures beyond those proposed by the President and the power of the Senate to increase expenditures beyond those voted by the House. The result is a triangular competition in extravagance.

Nothing quite parallel exists in any other leading country. No other country could afford it. In Great Britain the wholesome rule has been immemorially established that Parliament has no power to increase expenditures beyond those proposed by "the government." The Congressional "power of the purse" can be rightly understood only as the power of withholding or denying the purse. When Congress can put its own hands in the purse, in order to propitiate pressure groups, then there is no one left to represent the interests of the taxpayers. It is only when Congress has the power of reducing expenditures, but not of increasing them, that competition in economy will supplant the present competition in extravagance. ❁

## Can We Prevent Depressions?

June 29, 1953

The views of Arthur F. Burns, now serving as Economic Adviser to the President, should be of interest to every businessman, for they may affect the future of his firm. An excellent synopsis of them can be obtained from Dr. Burns's last annual report, just published, as director of research of the National Bureau of Economic Research, the private organization from which he has taken a leave of absence to assume his government job.

Much in Dr. Burns's statement is excellent. Government action against depressions, he reminds us, must also mean action against the preceding unsound booms. Yet political officials, "while earnestly resolved to do away with depressions, sometimes seem to neglect the need of controlling booms and trust too exclusively in our ability to check any contraction that may get under way." What preceding official has had the economic insight, sincerity, and political courage to point this out so clearly?

Dr. Burns says many other good things. "There are no adequate grounds, as yet, for believing that the government will resist inflation with as much tenacity as depression. . . . Not only is the art of contracyclical action as yet imperfectly understood, but there are practical obstacles [such as the existence of political pressure groups] to the effective use of such knowledge as exists."

But after he has said all this, Dr. Burns still seems to be convinced that governments both can and should undertake what he calls "contracyclical policy." He quotes with apparent approval the statement of Mr. Eisenhower that "never again shall we allow a depression in the United States. . . . [If signs appear] of any . . . depression that would put . . . men and women out of work, the full power of private industry, of municipal government, of state government, of the Federal government will be mobilized to see that that does not happen."

Dr. Burns himself makes the following statements: "Since 1929 . . . social control of business cycles has emerged as a political necessity, both domestically and internationally. . . . Our economic system will continue to generate cyclical tendencies. . . . It is reasonable to expect that contracyclical policy will moderate the amplitude and abbreviate the duration of business contractions in the future. . . . Perhaps, before many years pass, an economic general staff will emerge within the government and take on some of the characteristics of military general staffs."

Some of the implications of these statements are disturbing. They imply that there is some inherent

tendency in the capitalistic system to “generate” cycles and depressions, but that continuous government intervention could correct or at least “moderate” this. They assume that party politicians will act with more foresight and objectivity than private producers. An economic general staff, in particular, implies a quasi-military staff giving orders to businessmen on when to expand and when to contract. Some of us had assumed that the main trouble in the Communist, Fascist, and Socialist countries was that they already had such “economic general staffs.”

I would like to suggest a different approach to business cycles. It is no accident that the most violent fluctuations in prices, production, and employment have corresponded with the period of most government interference in business. Most major modern business oscillations have been the result either of credit and currency expansion deliberately instigated by government, followed by inevitable collapse, or at least by failure of government to halt an unsound credit expansion until too late. The best government “contracyclical” policy would be to keep an inflationary boom from starting, not to try to whip it up again after it has begun to flag. Governments need no encouragement to do the latter; it is, in fact, almost impossible to stop them. But they have no appetite whatever for doing the former and have almost never been known to try. ❁

## The Return to Gold

July 6, 1953

It is good news that the Yale University Press has made available a new edition of *The Theory of Money and Credit*, by Ludwig von Mises (493 pages, \$5). In his introduction to the English-American edition in 1935, Lionel Robbins wrote: “In Continental circles it has long been regarded as the standard textbook on the subject.”

To this latest edition the author has added a new section of 44 pages on the present problems of monetary reconstruction. No two economists seem to agree in every detail regarding the monetary policies that should now be adopted and the order in which particular steps should be taken, but Mises’s discussion seems to me on the whole the soundest, most thorough, and most illuminating that has so far appeared.

No one, for example, has explained better than Mises the detailed process of inflation and the exact nature of the evils it entails. His basic argument for a return to the gold standard is nontechnical: “The excellence of the gold standard is . . . that it renders

the determination of the monetary unit’s purchasing power independent of the policies of governments and political parties. . . . It makes it impossible for them to inflate.”

Today, unfortunately, only a minority of economists agree that it is both possible and desirable to return eventually to a gold standard. When it comes to such questions as *when? under what conditions? how? and at what rate?* even this minority of gold-standard advocates is split 40 different ways.

Mises’s answer runs something like this: Monetary reform presupposes first of all a change in the prevailing economic ideology. “There cannot be stable money within an environment dominated by ideologies hostile to the preservation of economic freedom.” The first step must be to put an absolute halt to any further monetary inflation. “The main thing is that the government should no longer be in a position to increase the quantity of money in circulation and the amount of check-book money not fully—i.e., 100 percent—covered by deposits paid in by the public. . . .

“At the same time all restrictions on trading and holding gold must be repealed. The free market for gold is to be re-established. Everybody, whether a resident of the United States or of any foreign country, will be free to buy and to sell . . . to import and to export, and, of course, to hold any amount of gold, whether minted or not minted. . . . In this first period of the reform it is imperative that the American Government and . . . the Federal Reserve System keep entirely out of the gold market. . . .

“It is probable that the price of gold established after some oscillations on the American market will be higher than \$35 per ounce. . . . It may be somewhere between \$36 and \$38, perhaps even somewhat higher. Once the market price has attained some stability, the time has come to decree this market rate as the new legal parity of the dollar and to secure its unconditional convertibility [into gold, and vice versa] at this parity.”

Regardless of their merits, these proposals are unlikely to get serious official consideration at this time. Very few monetary economists, for example, today favor anything as drastic as a prohibition of any increase in bank deposits (and, incidentally, in bank loans) beyond an increase of the same amount in gold reserves. Even most supporters of a return to the gold standard merely wish to stop the kind of credit expansion that comes through bank purchases of government bonds, not the kind that comes from an increase in the total volume of loans to business. And even most of those who favor a restriction on loans to business wish to carry it out solely through increases in interest rates (and perhaps



in member-bank reserve requirements) rather than through any direct quantitative limitation.

But though there will be dissent from some of his detailed conclusions, Mises's answer cannot be neglected by any serious student of the problem of returning to a gold standard. And that return is imperative if the world is not to drift even deeper into monetary chaos. ❁

## Return to Inflation

July 13, 1953

The Eisenhower Administration started out bravely to halt inflation. It refused at first to resume Federal Reserve support of government securities. It tried to get away from the inflationary policy of financing Treasury deficits by short-term notes, certificates, and bills sold to the banks. It resolved to start financing itself with long-term bonds, even though it had to pay 3¼ percent. But as soon as interest rates, as an expected consequence, became a little tighter, a chorus of complaints came from Congressmen, labor officials, bankers whose old bond holdings were dropping in value, and business firms which had to pay more for borrowing. The Administration took fright. In mid-May, the Federal Reserve System began purchasing Treasury bills in the open market. By June 17, it had bought \$525,000,000 of government securities.

Then on June 24 it took the most inflationary step of all. It reduced the reserve requirements of member banks. This action, it estimated, would release \$1,156,000,000 of reserves, which in turn would give the country's banks another \$5,780,000,000 or so in lending power. All this was frankly done in anticipation of Treasury needs of some \$6,000,000,000 of "new money" in the next three months.

Between the end of 1939 and the end of April this year, the country's supply of money and bank credit was increased from \$64,700,000,000 to more than \$195,000,000,000. This tripling of the money supply is the inflation that everybody talks about. It is the primary reason for the great increase in prices. Now the government wants to increase the money supply by \$6,000,000,000 more. It is back in the business of printing fiat money for deficit financing.

It is being said in apology for the Federal Reserve action that the system could not help itself. The deficit at the end of the fiscal year just closed was \$9,389,000,000, the largest in peacetime history. The deficit expected

for the fiscal year just begun is \$6,000,000,000 to \$7,000,000,000.

As one commentator has shrewdly put the matter: "So long as the government runs a deficit the deficit will control the money managers and not the money managers the money." Yet this is only partly true. The Treasury could conceivably finance the deficit by long-term bonds paid for out of real savings. But it just doesn't want to pay the interest rate which this would involve.

The new Administration, moreover, cannot escape responsibility for the state of the budget. Mr. Eisenhower was in charge of spending for nearly six months of the fiscal year just closed. He will be in charge of spending for the entire fiscal year just begun. In spite of heavy spending commitments carried over from the Truman Administration, Mr. Eisenhower is not powerless. He could cut the budget in scores of places where he has not done so. There is no sound economic reason, but only political reasons, for the billions we are paying out for high support prices for farm commodities. There is no longer any impelling reason (if there ever was one) for giving billions of the taxpayers' money away to foreign countries. Yet we are in fact planning to give some \$6,500,000,000 away (or just about the amount of the expected inflationary deficit) in the present fiscal year. Several of his statements and actions, indeed (including his appeal to Congress for power to give away "surplus" food to foreign countries) indicate that Mr. Eisenhower has been infected by Mr. Truman's foreign handout ideology.

In brief, on top of an inflation that the Democrats have been building up for twenty years, a Republican Administration is planning another heavy dose of inflation. This record demolishes the entire dream-theory that we can depend for salvation on something called "governmental contracyclical policy." Governments know only how to inflate; they have no stomach for halting an inflation, and never try until it has gone so far that it cannot be stopped without threatening a crisis. The best contracyclical policy is to deprive governments of the power to inflate. ❁

## End Foreign Aid Now

July 20, 1953

The United States has spent \$92,500,000,000 in foreign aid since 1941. Now, at long last, there are signs in Congress of a revolt against indefinite continuance of the program.



Sen. Walter F. George, Democrat of Georgia, served notice on July 1 that he was voting for the last time for any authorization for the Mutual Security Agency. If the nations of Western Europe were unable to stand on their own feet after seven years of foreign-aid programs, he said, "they never will be." A still greater surprise came when Sen. Mike Mansfield, Democrat of Montana, a traditional supporter of foreign-aid programs, offered an amendment, which the Senate adopted, to terminate the Mutual Security program on June 30, 1955 (instead of 1958).

There are many reasons behind this change in opinion. Some of them can be found in the facts summarized in a recent study by the Tax Foundation. Industrial production had reached prewar levels in most European countries by 1947, and in all of them by 1951. Agricultural production in general exceeded prewar levels by 1949.

So far as defense aid is concerned, I pointed out in this column of June 15 that the United States is spending on national defense more than four times as much absolutely as ten European arms-aid-receiving nations combined. It is also spending—twice as much *relatively*—15 percent of its gross national product against an average of 7 percent for the ten beneficiaries. Finally, the United States is spending 70 cents out of every tax dollar on defense, whereas these European nations are spending only 30 cents out of every tax dollar on defense. They are spending the other 70 cents on such things as deficits on their socialized industries, overgrown social-security systems, and subsidies to unprofitable and inefficient industries. Some of them act as if their defense were primarily a favor to us, and we should pick up the check.

It is beginning to be recognized, finally, that our economic aid has not only failed to speed up a return by Europe to sound economic policies, but that it has actually been used to finance the socialization of Europe. As the economist F.A. Hayek has put it: "There can be no doubt that, because of American financial assistance, governments of many countries now control economic activity to a much greater extent than would otherwise have been the case. Because of the form in which the United States has chosen to provide capital for these countries, their governments, in turn, have become the main dispensers of capital. When a government thus becomes the main source of investable funds, it inevitably speeds up the process of government domination of business."

Will Congress really accomplish anything by setting a deadline for foreign-aid "programming" in 1955, and for spending in 1957? This is more likely to be

interpreted abroad as a promise to keep the handouts going at least until that time. Paul Hoffman used to announce frequently the forthcoming termination of ECA; but it merely changed its name to MSA and cost us just as much.

Why not terminate new foreign-aid appropriations right now? After all, more than \$10,000,000,000 of unexpended balances for foreign aid still remain on the books, even if Congress does not appropriate another penny.

If Congress does think it has to appropriate more, why not make the funds available strictly in the form of loans, to be paid off, say, in equal monthly installments of principal and interest over 25 years? Congress would probably be surprised at how little need European governments found for such repayable loans. Congress might even supplement this by limited government guarantees of private loans abroad under the strict conditions suggested by F.A. Hayek in an article in *The Freeman* of April 6.

We just had a deficit for fiscal 1953 of \$9,389,000,000. We face a deficit for 1954 approaching \$7,000,000,000. Surely the day of the huge handout to foreign nations, on any sort of facile rhetorical plea, ought to be over. ☼

## How We Support the World

July 27, 1953

The Senate Appropriations Committee has received a staff report which questions whether the French "will ever put their fiscal house in order and balance their budget by collecting the proper amount of taxes as long as they receive United States aid. . . . Taxation of the rich is on a primarily low level. . . . What we are doing with our economic aid is simply giving the French a certain amount of money and exercising no real control over how it is spent."

These observations are harsh but justified. Yet there is nothing particularly new about them, except that a Congressional committee staff has now had the courage to make them. It has been inherent in the situation all along that without American dollars the government of France (or of any other country receiving our aid) would either have to spend less money or increase its own taxes. It is also inherent in the situation that the only way in which we could exercise real control over how our dollars are spent would be to dictate and supervise every item of the French budget—which no one has dared to propose.

It is obvious that it does little good—that it is in fact fatuous as well as futile—to "earmark" our foreign-aid

funds for specific purposes, to set up special “counterpart funds,” and all the rest. To the extent that we pay for France’s defense, France does not have to use its own money for defense. Therefore its government can use the money it saves on defense to spend for any other purpose it pleases: In the fiscal year 1952, in fact, 62 cents out of every dollar it spent went for nondefense items.

On July 14, a dispatch from Harold Callender, Paris correspondent of *The New York Times*, attempted to answer the Senate committee staff’s report, but missed the point completely. The Mutual Security Agency, wrote Callender triumphantly, “controls the use of the funds granted to finance a specified list of defense purchases . . . or to increase French productivity. Its control is constant.” But none of this proves that the French would not otherwise be spending their own money for these purposes, or that they could not have increased their own taxes to do so.

As I wrote in illustrating this point in *Will Dollars Save the World?* published six years ago: “If you make a loan to a family that keeps a car for pleasure, nothing is gained by the assurance that the particular dollars you have loaned have gone only to buy food, and that the automobile was bought and run with the family’s own earnings. Even if you could verify by the numbers on the bills that your particular dollars were spent only for food, you would know that your loan was being used *in effect* to keep the car—because the family would otherwise have to give up the car and use its own earnings for the food.”

So it is just as fair to argue that the dollars we pour into France pay the deficits on its nationalized industries, or support its overexpanded social-security system, or relieve its rich citizens of taxes, as to contend that they go only for defense or the purposes for which they are “earmarked.” It is also just as fair to say that we are prolonging our excess-profits tax, with all its admitted harm to our new enterprises, efficiency, and production, in order to help subsidize Europe’s socialism, or to relieve Europe’s wealthy citizens of heavy taxes so that they may continue to patronize the luxury hotels on the Riviera.

We are doing all this because we have got ourselves snarled up in economic, political, and moral confusions. We have been sold the idea that we must assume something vaguely called “world leadership”—which turns out to mean “assuming our world responsibilities”—which turns out to mean supporting people all over the world so that they may realize what they call their “legitimate aspirations.” We have acquired a Santa Claus complex, an Atlas fixation, and a giveaway mania.

And we are solemnly told by our own leaders that if we ever halt our foreign bounties the world will “lose confidence in us,” and our allies will last only as long as our handouts. ☸

## How to Help Small Business

August 3, 1953

The blunders and scandals connected with the Reconstruction Finance Corp. led to a mounting demand that the agency be abolished. So Congress has voted to terminate it—and to create something just as bad to take its place.

The new institution will be known as the Small Business Administration. Congress seems to think this will be better, because it will not be authorized to make any individual loan of more than \$200,000. But it may actually be worse. What caused the public demand for the abolition of the RFC were the mink-coat scandals in connection with the \$37,500,000 loan to the Lustron Corp. and the misgivings that grew out of the \$69,400,000 loans to Kaiser-Frazer. These large loans captured the headlines. But where no one loan is big enough to dramatize the situation, blunders, politics, and corruption may continue to be tolerated.

Loans by a political agency are inevitably more political than economic. Congressmen did not hesitate to bring pressure on the RFC to grant loans to their constituents. Obviously they will hesitate much less to do this in connection with small loans than in connection with large ones.

The sentiment in favor of government loans to private business rests on a belief that there are all sorts of worthy projects, particularly small ones, that cannot get started because private bankers or investors do not have the courage and vision to see the possibilities in them. No doubt there always are a few worthy projects of this sort. Private bankers and owners of loanable capital are not omniscient. But it does not follow that a government lending agency will know how to correct these private errors. On the contrary, it is enormously probable that for every sound project it finances that private capital would not finance, it will finance half a dozen marginal projects, from snack bars to snake farms, that private capital had quite wisely turned down.

Government agencies are bad gamblers from the nature of the case. The private investor risks his own money.

He may stand either to make a handsome profit or to lose his entire capital. Therefore he is likely to

scrutinize a project very carefully before he risks that capital. A government agency, on the other hand, is not risking its own money, but merely the taxpayers'. The SBA loans are almost certain to be dubious, moreover, from the very terms under which they must be made. Private-loan sources must be exhausted before a small business can come to the SBA for a Federal loan. This means that the SBA can risk the taxpayers' money only on projects in which no one has been found willing to risk his own money.

Some people suppose that a government agency will at worst finance some unsound projects, and only the long-suffering taxpayer will take the loss. But at any given time there is a limited amount of available capital. The government does not create any new capital; it merely takes some away from the taxpayer. So the capital that the government agency lends to Y for an unsound and unprofitable project is in effect taken away from X, who would have got it for a sound project from taxpayers who had to turn it over to the government lending agency instead. A government lending agency, in short, because it is never primarily concerned with profitability, not only finances inefficient and unprofitable ventures but indirectly deprives efficient and profitable ventures of funds.

The best thing the government can do for small business is not to "aid" it but to stop penalizing it. The best way to have stopped penalizing it was to have let the excess-profits tax expire instead of forcing its extension. The government, having tied the legs of profitable, efficient, and growing small business by extending the excess-profits tax, is trying to compensate by giving crutches to unprofitable and inefficient small business through a new lending agency. The real way to help small business is to let inefficiency and bad judgment suffer their natural penalties, and efficiency and good judgment reap their natural rewards. ☼

## Competition in Extravagance

August 10, 1953

Immediately after the House voted to slash \$1,115,050,000 from the \$5,157,232,000 President Eisenhower had asked for foreign aid, he appealed to the Senate to restore the cut. The Senate Appropriations Committee—and the Senate—promptly restored approximately half of it.

The House rightly decided that, above all in an inflation and in the midst of a private-housing boom, there was no excuse for continuing a public-housing program. It voted to eliminate it. The Senate restored

the program to 35,000 houses, whereupon the House was compelled to compromise on 20,000.

The House voted for only some \$60,000,000 for the Overseas Information Service. The Senate increased the amount to \$80,000,000.

And so it goes. There is nothing unusual in this record. In every session of Congress the Senate pretty regularly outbids the House in its vicarious generosity with the taxpayers' money. The Senate's record in this session, in fact, is much better than usual; there are even cases in which it made a smaller appropriation than the House.

The main reason for this superior extravagance of the Senate is simple. The House usually acts first on appropriation bills. A senator has little to gain politically merely by me-tooing the liberality of the House. The way to political credit for generosity is to vote for an *increase* above the House appropriation. Thus we have a system which creates a three-way competition among the President, the House, and the Senate to outbid the others in the amount of money each recommends or offers for special purposes or to special groups at the expense of the American taxpayer.

It may be seriously doubted whether this corresponds with the intent of the framers of the Constitution. Article I, Section 7, provides: "All bills for raising revenue shall originate in the House of Representatives." In practice this has been strictly interpreted to apply solely to tax bills; but the framers probably also had *appropriation* bills in mind. They seem to have thought of appropriations and the taxes to pay for them as inseparable parts of a single legislative process. This is indicated by the odd fact that the Constitution nowhere directly and explicitly, but only by implication, confers power on either house to make appropriations.

There are three ways in which the present triangular competition in extravagance among the President, the House, and the Senate could be ended:

1—The Constitution could be amended so that the Senate would have to wait until the House had acted first, not only on tax bills, but on appropriation bills; and the Senate would be given power to eliminate or reduce, but not to increase, any appropriation made by the House.

2—Better (corresponding to British practice), Congress as a whole would have power to reduce, but not to increase, any appropriation asked for by the President.

3—Still better, the House would have power to reduce, but not to increase, any appropriation asked for by the President, and the Senate would have power to



reduce, but not to increase, any appropriation made by the House.

This last arrangement would substitute a three-way competition in economy for the present three-way competition in extravagance. It would change the entire atmosphere of budgetary discussion. With no power to increase appropriations or to outbid the Executive or the Congressional majority, the minority in opposition would devote its zeal and ingenuity to suggesting economies. This would tend to eliminate from Federal public life the worst type of politician, who gets into office by out-promising his rivals concerning handouts from the public till.

It may be objected that this whole proposal is utopian because neither the Senate, nor Congress as a whole, would ever consent to give up its present prerogatives. But on the other hand, we are rapidly reaching the point where the country can no longer afford the present system. ☸

## Raising the Debt Limit

August 17, 1953

It is fortunate that Congress did not immediately grant the President's request to increase the legal national-debt limit from its present level of \$275,000,000,000 to \$290,000,000,000. Immediate acquiescence by Congress, as Senator Byrd put it, would have been "an invitation to extravagance." A suspended decision, on the other hand, will give both time and occasion to re-examine the whole problem of government spending.

The Administration's argument for raising the ceiling was that the national debt was already more than \$272,000,000,000, and that expenditures between now and Jan. 1 are expected to exceed receipts by \$7,300,000,000. In reply, Senator Byrd pointed out that the Treasury already had a \$9,000,000,000 cash balance in the general fund, "which should be ample to cover this five-month deficit, and if not, there will remain \$3,000,000,000 in addition which may be borrowed under the existing debt limit."

In addition, Senator Byrd said: "The President has the authority, if he chooses to use it, to place every agency of the government on an expenditure ration and limit the expenditures in such manner as he deems best. . . . We all know there are thousands of ways to reduce government spending that can be accomplished by Executive order without impairing benefits as measured by real value."

The basic solution of the debt problem, in short, is not to keep raising the debt limit but to balance the

budget by bringing expenditures down to a reasonable level of taxation. Spending in the fiscal year 1954 seems likely to equal or approach spending in the year that ended June 30. That itself was higher than in any full Truman year. Yet Mr. Eisenhower fought hard to get Congress to authorize very dubious 1954 expenditures, such as the tremendous sum of \$6,652,000,000 for foreign aid.

One of the arguments of Secretary Humphrey in favor of raising the debt limit was the need of keeping a huge cash balance: "You can't run this government with this level of expenditures on less than about a \$6,000,000,000 cash amount because you are spending at the rate of about \$6,000,000,000 a month." This argument may boomerang. It may remind the country that we are now spending in a single month almost as much as Franklin Roosevelt in his first term spent in a full year.

It is of course self-contradictory for Congress to approve tax cuts and expenditure increases that make additional debt inevitable, and then refuse to approve the additional debt. The question has even been raised whether a legal debt limit serves any valid purpose at all. Yet it does. It acts as an alarm clock, a pressure gauge, a "dangerous curve ahead" sign. It is merely a foolish and perilous misuse of these devices to turn off the alarm and go back to sleep, to substitute another pressure gauge when the first one reaches the red mark, or to move the sign beyond the curve instead of in front of it. This is in effect what Congress has been doing over the years. From 1941 to 1945 it raised the debt limit five times. It is worse than pointless for Congress to set a debt limit unless it really means it.

Though it may now be too late for Congress to refuse to raise the debt limit at its next session (or even at a special one), it would be folly to grant that increase without insisting on some *quid pro quo* in return. This might take the form of passage of the Coudert resolution (already approved by the House Government Operations Committee) which would prohibit the Administration from spending more than it took in during any year except in wartime or of grave emergencies declared by Congress. Congress might even, in return, submit a constitutional amendment to give the President power to veto individual items in appropriation bills. Better, it might deny itself the power to appropriate more than he had recommended. Any one of these moves would help to substitute competition in economy between Congress and the President for the present competition in extravagance. ☸



## Eisenhower So Far

August 24, 1953

The most important economic achievement of the Eisenhower Administration so far has been the abolition of price control. The Truman Administration had imposed price control on the excuse that it was needed to “fight inflation.” All that it really did was to unbalance and curtail production, bring on shortages, enable partisan bureaucrats to exercise life-and-death powers over particular industries and firms, and encourage the continuance of inflation by diverting public attention away from its real cause, which was the creation of more money and credit by the government itself. Spokesmen for the Truman Administration kept shouting that to allow price controls to lapse would be to turn over the country to “the profiteers” and to let loose the floodgates of an uncontrollable inflation.

President Eisenhower nevertheless moved boldly ahead and dismantled price control within a comparatively few weeks. The predicted “inflation” never came. On the contrary, the wholesale price level fell from an index number of 109.9 in January to 109.4 in June, while the cost-of-living index remained about stationary. Once more a complete demonstration had been made of the fraudulence of price control as a cure for inflation. But if any New Dealer has acknowledged the folly of his prediction, I have yet to hear of it. Instead we have the comic spectacle of Sam Rayburn, for example, simultaneously complaining about a rise in prices and about a fall in prices: “Prices of many commodities are rising. . . . Farm income is down 14 percent.” But farm income is down only because farm prices are down. City workers are paying less for foodstuffs.

What really brought inflation to a halt was the courage of the Eisenhower Administration and its monetary managers in halting the policy of cheap money. But the government suddenly took fright at the complete success of its own hard-money program and threw it into reverse. On June 24 it reduced reserve requirements in order to give the country’s banks some \$5,780,000,000 in additional lending power.

This sudden reversal of the anti-inflationary policy was symptomatic partly of a loss of political nerve on the part of the Eisenhower Administration and partly of acceptance of the New Deal economic philosophy. The same performance was repeated in farm policy. Secretary Benson made one bold speech against the fantastic farm-price supports and ran away from it as soon as the bricks began to fly. Mr. Eisenhower in his campaign talked boldly of economy and tax reduction. He has ended by setting up a spending budget for

fiscal 1954 of \$74,000,000,000—higher than in any full Truman year. He has insisted on a huge foreign-aid program of \$6,652,000,000 a year. He has asked for authority to raise the debt ceiling to \$290,000,000,000 (though his recent economy order gives renewed grounds for hope).

Finally, and most ominous, he has allowed officials in his Administration to prepare amendments to the Taft-Hartley Act that would scuttle practically every reform brought about by that law and put individual workers, employers, and the country at the mercy of irresponsible union bosses.

It is surely not without good grounds that the Democratic National Committee boasts that most of the Eisenhower achievements in office so far “are merely continuations of Democratic programs.” I happen to agree that one or two of these “Democratic” policies—such as extension of the reciprocal-trade program and the simplification of customs regulations—were sound and praiseworthy. But if Mr. Eisenhower decides to continue the bulk of the New Deal spending, taxing, deficit, inflation, foreign and domestic handout, and pro-union-boss policies, he is not only likely to head the country into economic crises but to lead his party into defeat in 1954 and 1956. The American people in the last election voted for a change. There is still plenty of time for Mr. Eisenhower to renew the courage and convictions of his original start. ☸

## The Futility of Foreign Aid

August 31, 1953

Nothing has more conclusively demonstrated the complete futility of our foreign-aid program than what has been happening in France. One of the chief purposes of the foreign-aid program was to try to put France politically and economically on its feet, to remove or reduce the influence of the Communists, and to help make France into a strong and dependably ally. Not one of these objectives has been achieved.

Certainly we did not spare expense. A recent report by a Senate staff committee headed by Alex L. Hillman estimated that from April 3, 1948, to Jan. 31, 1953, United States assistance to France and Indo-China alone totaled some \$10,900,000,000. This is more aid than went to any other country in that period. What have we got in return?

Certainly not monetary or economic stability. The franc now stands at less than 4 percent of its pre-war value. Nor is the situation such as to give anyone

confidence that it will be stabilized even where it is. The budget has been chronically unbalanced. The government has been reduced to short-term borrowing at the Bank of France—i.e., to printing more paper money. As A.E. Jeffcoat pointed out in a recent article in *The Wall Street Journal*, French public spending, which swelled from 1949 to 1953 by 40 percent (while national income rose only 9 percent) presently chews up nearly half of France's national income. Government "investments" in both nationalized and private industry take up about 26 percent of state spending. Subsidies to groups like exporters and alcohol distillers use up 9 percent of the nation's budget. The state social-welfare program consumes about 12 percent.

Our aid has not brought political stability to France. A French government now stays in power, at best, for a few months. Weeks may pass with no government at all. About as many voters still vote Communist as before Marshall aid began. The Communists can still impose paralyzing strikes. In fact, the Communists are hardly needed for this purpose. It has now been demonstrated that if any Premier even attempts to take the measures that are absolutely essential to halt inflation and restore solvency, unions of every political color will go on strike.

Has our military aid made France a strong and dependable ally? There is little evidence of it. As I have pointed out here in previous columns, to the extent that we pay for France's defense, France does not have to use its own money for defense. In the fiscal year 1952, 62 cents out of every dollar the government spent actually went for nondefense items—largely of the welfare-state type specified above.

Has our aid to France and other countries brought us their gratitude, friendship, and good will? Has it made them into stauncher allies? Almost every dispatch from Europe today reports the opposite. On Aug. 10, William Philip Simms wrote to the Scripps-Howard newspapers: "The biggest peril to American people today is not Soviet Russia, but the growing anti-Americanism here in Western Europe. And it is ranker among those for whom we have done the most." Warren H. Phillips made a similar report to *The Wall Street Journal* a few weeks before, explaining how anti-Americanism has been *caused* by our help: "Taking charity by itself is pride-destroying. But it is doubly so when the recipients come to believe that their governments have bartered their foreign policy and domestic political independence, too, in return for U.S. aid."

The money we are now pouring into foreign aid is worse than thrown away. It subsidizes and prolongs extravagance and socialistic policies that Europe would otherwise have been forced to abandon long ago. It

produces anti-Americanism in European foreign policy as a proof of "independence." Yet we are scheduled to spend the tremendous sum of \$6,652,000,000 for foreign aid in the present fiscal year, and the President has implied to Congress that foreign aid must continue indefinitely. ❀

## 'Foreign Economic Policy'

September 7, 1953

President Eisenhower and Congress have jointly appointed a seventeen-member Commission on Foreign Economic Policy, under the able leadership of Clarence B. Randall, which is to make a thorough study of the subject and report to Congress next spring.

Actually, the subject is not nearly as intricate and baffling as it is usually made out to be. Most of what is worth saying on the subject has already been said many times. Lewis W. Douglas, for example, our former Ambassador to Great Britain, has already turned in a report to the President that covers most of what the commission is likely to find out. Given the mixed political composition of the commission, indeed, the country will be fortunate if its report turns out to be, on the whole, nearly as sensible and balanced as the Douglas report. Obviously, the best way to increase the volume of world trade is to reduce or remove the barriers to it. And as it is always sound ethical policy to extract even a mote from our own eye before calling attention to even a beam in our neighbor's, the first thing for us to do, as Douglas insists, is "to commence to remove from our own policies the impediments to freer trade and currencies." The Eisenhower Administration has already made a good start by continuing the reciprocal-trade treaties and by some simplification of customs procedures. But to set a good example it should reduce tariffs even further. Certainly it should abolish import quotas, which are far more disruptive to foreign trade and good relations than even a formidable tariff barrier.

Nevertheless, if we were to wipe out the last vestige of our own tariffs and quotas, it is doubtful whether, except in a few special items, our imports would increase very much. For by far the major barriers to our foreign trade today are erected by other nations. Bilateral treaties, import quotas, and prohibitions, and above all, exchange control, which are practiced, with our tacit approval, by most of our aid recipients, not only reduce and disrupt foreign trade incomparably more than tariffs do, but inevitably lead to "planned" and regimented domestic economies.

The Douglas report also emphasized the need of restoring international private investment. This would promote the most rapid world economic expansion, particularly the expansion of the so-called underdeveloped areas. But what is still not generally recognized is that the greatest obstacle to the restoration of international private investment is the existence of governmental handouts from the United States. For private investment is made only where the political and economic climate is attractive. This means, among other things, assurance against socialization, seizure, excessive taxes, onerous price-fixing, wage-fixing, or profit limitation, and obstacles to the transfer of profits or currency. But it has been found by experience (what should have been obvious anyway) that as long as an "underdeveloped" country can cajole or blackmail the United States Government into giving it handouts, it need not make, and will not make, any of the reforms necessary to attract private capital.

Iran provides a perfect illustration. Mossadegh having impoverished both the government and the country by seizing the British oil refineries, his successors demand our aid while still insisting that they must keep the stolen property. And if (under their threat or our fear that they will otherwise go Communist) we are foolish enough to give them this aid without demanding the return of the expropriated property to its British owners (or at the very least reasonable compensation for it), then we shall not only be condoning but encouraging such seizures everywhere, thereby still further postponing any restoration of international private investment. The policy of making U.S. Government handouts to foreign socialistic governments not only fails to enrich the world but tends to impoverish it, because it sets back the economic recovery of the recipient country as well as our own. ☸

## How to Kill Capitalism

September 14, 1953

There has lately been a rising protest against the tremendous tax burden now placed on the American people. The protest is most impressive when it rests, not primarily on the argument that our present tax structure is inequitable (though that is true enough), but on the ground that existing taxes are killing incentives and thereby undermining the productiveness of the entire economy.

An excellent speech on what taxes have been doing to incentives was delivered this spring at a conference of the National Industrial Conference Board by David McCord Wright. Professor Wright devoted himself particularly to assailing the alleged "statistical proof" on the part of some of his academic colleagues "that incentives are unnecessary, that the harder you tax the businessman the harder he will work; and that . . . the American 'rags to riches' myth is mostly bunk anyhow."

Wright did not have too much trouble in disposing of the alleged "scientific basis" of these statistics, or in revealing the bias behind them. He caught some of his colleagues arguing in the same breath that the destruction of capitalistic opportunity has been a good thing, and, anyway, that such opportunity never existed. And he found that they failed also to distinguish between the effects of present onerous taxes on the incentives of the older generation, who formed their working habits and ambitions in an earlier era, and the effects of such taxes on a younger generation who are forming their habits and ambitions now. "The older men," he concludes, "may stick in hectic business or professional life under present taxes, because, already caught in the rat race, they may still work hard in order to keep their accustomed standard. The younger men, I believe, will increasingly just say: 'What the hell!'"

Wright's argument is mainly negative. He shows, that is, that the alleged statistical proof that business executives "will work harder if you tax them more" is spurious and worthless, just as the proposition itself is on its face contrary to common sense.

But he could have gone on to show, if he had wished, that there is plenty of statistical evidence, of a far less dubious nature, that excessive taxes destroy incentives.

In the case of personal income taxes, for example, it is notorious that higher tax rates have failed to yield proportionately higher revenue. In fact, in the highest income brackets there is the strongest statistical evidence for the conclusion that present confiscatory rates have actually *reduced* Federal revenues. In these brackets, in other words, lower rates would *increase* revenues.

These results occur because excessive tax rates reduce the income to which they apply. They reduce it by destroying the incentives to earn it. The consequences of this trend, if long continued, are very grave for the future of our economy. Our present taxes are both undermining the incentives, and destroying the funds, for new investment. And it is precisely on these funds that the nation depends for increasing its productivity, which means the productivity, wages, and welfare of its workers.



All this should be obvious from a glance at present tax rates. Corporations pay the government a basic rate of 52 cents out of every dollar of earnings. Corporations that make “excess” profits pay the government 82 cents out of every dollar of them, or as high as 70 cents on every dollar of total earnings. This means that every individual who invests in a corporation, no matter if his own income is \$5,000 or less, pays a 52 to 70 percent tax on his earnings out of that corporation *before he even gets them*. If the corporation pays out all of its earnings in dividends, the stockholder may be taxed anywhere from 22.2 to 92 percent, in accordance with his personal income, *out of what remains over from the first tax!* Out of a corporate investment that would otherwise return him \$1,000 a year, say, a taxpayer in the highest brackets might have just \$24 left over for himself. What is that going to do to incentives to new investment? ❁

## Economists vs. Astrologers

September 21, 1953

I have tried to explain several times in this column not only why I do not attempt to forecast business conditions but why I do not believe that a science of economic forecasting is even possible. Therefore I was happy to see, in *Lloyd's Bank Review* of London in April of this year, the slashing attack by Prof. John Jewkes of Oxford on the fashionable idea that economists can predict the future:

“It cannot be too strongly emphasized that there is nothing in economic science which enables us to foretell events. Those who claim otherwise are dragging their subject down to the level of astrology. . . . There is nothing in history to suggest that the expected will normally happen. . . . Economic prediction as a scientific method is not merely absurd, because impossible, but dangerous, because seductive.”

Yet Professor Jewkes seems to me to commit the rare sin among economists of *overstating* the case against prediction. He does not distinguish between *conditional* prediction, which is possible, and *categorical* prediction, which is presumptuous.

He piles up, for example, a truly impressive list of economic predictions that have gone wrong in the last generation. But he does not distinguish between those that went wrong because the relevant facts were not known, and those that went wrong because of fallacies in economic reasoning that were detectable at the time they were made. Thus he cites the now discredited view “accepted by many economists, and disputed by

few” before the war, “that all advanced industrial countries were rapidly passing into a condition of maturity and secular stagnation.” But those who did dispute the view at the time correctly pointed out the fallacies on which it rested.

“It does not need much thought to understand,” writes Jewkes, “why prediction is so hazardous. It can almost be summed up in one word: invention.” But while unforeseen inventions are an important reason why some economic predictions go wrong, they are far from the sole or even the main reason (especially where short-term predictions are concerned). There are two main reasons. One is that the facts and factors which must be taken into account to predict the future are too numerous and complicated for any human mind to grasp. The other is that, in human affairs, predictions themselves change the future they predict. A belief that prices of stocks will rise next year, for example, if prevalent enough in Wall Street, will cause speculators to act in such a way as to bring about a price rise immediately.

Yet Jewkes seems to overstate, as I have said, the case against economic prediction—which means, among other things, the case against business forecasting. And this is all the more remarkable in view of some of his admissions: “Every businessman must make decisions, particularly regarding investment, where hazard and conjecture are inherent. . . . Although no one can be sure about the future, men must by hook or by crook take thought for, and strive to be wise about, the future.”

It is precisely here, I think, that economic reasoning can play a more useful role than Jewkes assumes. While economic forecasting can never be a science, it can sometimes be a help. This necessarily follows from Jewkes's own admission that economists may properly concern themselves with cause and effect. To understand cause and effect is to that extent to be able to predict. Once we understand, for example, that an increased supply of money causes prices to rise, we can predict that if the government increases the supply of money, then, other things remaining unchanged, prices will rise. An honest business forecaster will, however, make all his forecasts frankly conditional, and merely probable. He is entitled to say: “If X, then probably Y.” This may not seem to offer much to those who are looking for certainty. But it may reduce the number and extent of our bad guesses and increase our batting average of good ones. And that can make a vital difference. ❁



## Italy's Creeping Capitalism

September 28, 1953

ROME—Controlism, statism, and socialism have lost a great deal of their former prestige in Western Europe. Yet even the statesmen who have ceased to believe in controls and government ownership do not seem to know how to get rid of them. Italy is an outstanding example. After eight years of leadership of anti-Fascist and anti-Communist Premier De Gasperi, the government is now in the hands of his former Treasury Minister, Premier Pella, a conservative who used to be described by De Gasperi as his economic conscience.

Although Italy several years ago got rid of general price fixing, a formidable network of controls remains. Under nationwide union contracts an employer cannot drop workers without giving them heavy terminal pay which may run a month for every year of service. This penalty, of course, makes for immobility of labor and forces employers to keep unneeded men. It produces featherbedding and inefficiency and discourages new hiring. If an employer is too inefficient to meet competition and has no more money to pay his surplus workers, the government subsidizes him.

Here we encounter a remarkable agency known as *Istituto per la Ricostruzione Industriale*, popularly known as IRI (pronounced Erie). This organization owns stock in most large Italian industrial companies. It uses the earnings of the profitable ones to pay losses in others. The government makes up the deficit that still remains. This, of course, promotes inefficiency, keeps the companies in business making the wrong things, reduces the capital available for expansion of needed production, and both directly and indirectly puts a needless drain on the government budget. The government owns and operates the railroads directly. Like our own government it subsidizes its wheat growers. It has kept rent control on old houses, which both discourages new building and further restricts the mobility of workers. Externally, it imposes exchange control and requires special licenses on dollar imports. In fact an Italian must get a license even to set up a new business at home. The individual Italian communes (roughly equivalent to our counties) often impose restrictions on the movement of workers and goods across communal lines. Italy retains the equivalent of general wage control. The Confindustria (a sort of super-NAM) and big unions (Communist and non-Communist) negotiate a master contract covering practically the whole of Italian industry. This is collective bargaining with a vengeance for it sets a bloc wage scale that controls every employer and worker. Registered unemployment is about 2,000,000

out of a working force of 19,400,000. The cost of living, as the result of past inflation, is now 56 times as high as in 1938. Where 31 percent of the electorate voted for Communism in 1948, 35 percent voted for it in the elections a few months ago. Such facts make the Italian economic situation look black. Yet in some major respects, it has never been better. The average hourly wage rates of all industrial workers are 75 times as high as in 1938; thus more than keeping pace with living costs. As measured by per-capita consumption of such important items of diet as sugar, milk, butter, and eggs, the Italians are eating better than ever before. And the official index of industrial production is more than 50 percent higher than in 1938.

Not the least important, Italy's inflation, as measured by the stability of the lira, has been halted. The official rate of 625 to the dollar was established in 1949 and the black-market rate has now fallen to practical identity with this. The import of gold coins, an important index to the lack of confidence in currency, has dwindled from 43 tons in 1951 to practically nothing. (In short, Italy is still suffering from a totalitarian hang-over—from the days of Mussolini's Fascism—but it is well on the path to reform. If it can now maintain a government devoted to the philosophy of economic freedom, its revival could become one of the most dramatic in the present era.) ❁

## The Welfare State in France

October 5, 1953

PARIS—Every economic discussion in France begins and ends with the political problem. If France could once get a stable government, great economic reforms would be possible and therefore it would be worth discussing them seriously. But as long as the political problem remains unsolved, economic discussion remains largely academic and controversialists deal in sweeping generalities rather than in any scrupulous study of the facts.

Take for example the case of wages. France is seething with labor discontent. One is told again and again that the French workers are shockingly underpaid but meaningful statistical comparisons are seldom even attempted. Here are a few for what they are worth: Wholesale prices in July of this year were about 25 times as high as in 1938. The cost of living in Paris was about 23 times as high as in 1938. Average hourly wages in 1952, however, were only about 15 times as high as in 1938.

This comparison, on its face, seems appalling. But the wage figures do not include the heavy social-security benefits. From the standpoint of the employer, these social payments are formidable. They total, on the average, 43 percent of his payroll. This total is made up of such individual items as family allowances, social insurance, workman's compensation, and a wage tax. But while all this adds tremendously to the employer's labor cost, it does not correspondingly help the individual worker, whose immediate income depends more on his family status than on his skill and effort. In April of this year, for example, the average wage of unmarried workers was 5,780 francs a week, whereas the average wage of a worker with a dependent wife and two children was 8,410 francs a week.

France has been trying to do, in short, what Italy also has been trying to do. It has been trying to transform the wage mechanism into a huge social-security system. But when a man with a couple of children gets 45 percent more than a bachelor, mainly because of a family-allowance system, the incentive to acquiring children becomes greater than the incentive to acquiring a skill. To put it another way, the incentive to reproduction becomes greater than the incentive to production. Such a system does not help the whole body of the workers; it hurts them instead. It is based on the false assumption that only "distribution" is of any real importance, and that production is somehow fixed and automatic. It leads to many bitter quarrels over exactly how an inadequate cake ought to be sliced and to neglect of the real problem of increasing the size of the cake.

It is the consensus of informed opinion that even when social benefits are included, an unmarried worker is worse off than he was before the war, although a man with three children is better off today. Such a system underpays and discourages the young at the outset of their career, precisely when their income is likely to be lowest anyway.

It should be obvious from the statistics that the workers in France are paying for their own social security. This is merely what economic theory would have led one to expect. But the fact is widely interpreted here as a result of the cupidity of the French employer. The explanation is at best inadequate. It ignores the fact, among a number of others, that French employers, as a result of result of many monopolistic protections, do not have to compete very strenuously with each other. If these employer protections were removed, the result might be dramatically different.

I am sorry that space does not permit a discussion of the results of rent control in France, or of the

quantitative restrictions on credit. But one summary statement is possible: The cure for the evils brought about by present French welfare measures is not still more radical welfare measures; it is the return to a free market, the revival of competition, the restoration—in a word—of genuine free enterprise. But the crucial question is whether this solution will be applied before it is too late. ☼

## Does England Need Controls?

October 12, 1953

LONDON—Everywhere in the world, where people are still free to express themselves, the prestige of socialism is clearly on the wane. Nowhere is this more strikingly demonstrated than in England. The Labour Party itself is split wide open on the subject of further nationalization. One speaker at the Margate Conference even declared that "nationalization is not the object of this party."

But it is a little difficult to say exactly how far the change in British social thought has gone. If the British people are beginning to be fed up with nationalization, they still give very few signs of being fed up with government "planning" and its accompanying controls. Nowhere is this better illustrated than in the case of exchange control. Exchange control is a totalitarian measure. Before the second world war it was imposed in Europe only in Hitler's Germany. Under it the citizens of a country are forbidden to buy or sell their own currency, or exchange it for any other, except at the fiat rate set by the government. To enforce such a control, the government must control all foreign trade. It does not allow exporters to keep or sell freely the dollars they earn. It does not allow its own citizens to buy what they wish from abroad, but only specified amounts of specified goods from specified countries or areas after they have obtained a special import license. A free-born Englishman is not even allowed to spend more than £40 (\$112) a year on foreign travel for pleasure.

When the government controls foreign trade in this way it in effect controls the whole economy. Under exchange control a free economy is impossible.

Now the most important step away from exchange control (implying, in fact, its virtual abandonment) is for a government to permit its currency once more to be fully and freely convertible into any other. And this is a more important requirement for sterling than for any other currency in the world. For London has been traditionally the world's banker. The world did business mainly in sterling.

Banks and business firms everywhere kept sterling balances in London to facilitate their trading operations and as temporary investments. As the value of sterling as a world currency lies precisely in its convertibility (into goods and other currencies everywhere), it follows that anything that prevents or restricts this convertibility lowers the value, the prestige, and the demand for sterling, and retards British recovery and expansion. Yet most of the bankers and government officials with whom I have talked here treat the problem of restoring sterling convertibility with indifference. Some of them even talk as if sterling convertibility were mainly something that Americans were pressing for and as if restoring it would be primarily a favor to us.

Even most of those who want to see convertibility restored treat the problem as too formidable for any present action. The British have, in fact, developed an altogether unhealthy sense of dependence on America. They talk as if the main requirement for convertibility were still further aid from us and a drastic reduction in American tariff barriers (with no corresponding reduction in theirs). Nearly everybody talks, in fact, as if the economic future of England were wholly dependent on the economic future of the United States. As one official put it to me: "When you get a cold, we get double pneumonia."

The question an American is asked on all sides is, "When are you going to have a depression?" which is like being asked, "When are you going to be sick?"—and a serious answer is expected. This is rather like building up an alibi in advance; the next bad turn for England or Europe is going to be, by prior definition, America's fault. This state of opinion is pathological. It paralyzes British initiative; and it is not supported by the facts. In 1952, for example, less than 6 percent of the exports of the United Kingdom went to the United States. If England threw away its crutches, it would be surprised to find how strong its legs really were. ❁

## How America Can Help

October 19, 1953

The slogan "Trade, Not Aid" was coined by the British, but most of them do not really mean it. What they still want, as I have pointed out here before is Trade *Plus* Aid; and their conception of Trade is one-sided rather than reciprocal. Some of them are candid enough to admit, when pressed, that what they want us to do is to abolish our tariffs entirely, while permitting them not only to keep theirs but to continue to discriminate

against American goods by quotas or prohibitions. All this is necessary, they blandly explain, to permit them to "close the dollar gap," to "restore the balance of payments," and to "build up reserves."

And they cannot, some of them insist, make the pound convertible unless America is ready not only to abolish its trade barriers but to make them a loan or gift of, say, some \$2,500,000,000 to add to their present "totally inadequate" gold and dollar reserves of \$2,500,000,000.

The American observer abroad finds, in fact, that our tariff is Europe's great alibi. For most Europeans it explains why they buy so much more from us than they sell to us; why they have a "dollar shortage"; and why their currency is weak. And they talk, usually, as if the American tariff were fantastically high, and as if their own countries had merely nominal trade barriers or were virtually practicing free trade.

A few facts might somewhat correct these notions. A study by the United States Tariff Commission has shown that the level of our tariffs dropped from 10.6 percent on all imports and 25.8 percent on dutiable items alone, before the Reciprocal Trade Agreements were adopted to 5.4 percent on all imports and 13.3 percent on dutiable items alone in 1951. By contrast, the American Tariff League has published figures to show that ratio of duties to *all* imports of the United Kingdom in 1951 was 25.6 percent.

Such crude averages, taken merely by themselves, provide inadequate comparisons. But they are enough to indicate that America is today not the sole or even the chief culprit in the matter of tariff barriers. Compared with the exchange controls, bilateralism, quotas, and prohibitions now prevailing in Europe, in fact, the American tariff is today a minor factor in restricting two-way international trade. As a result of a careful study, for example, Howard S. Piquet, formerly chief of the economics division of the United States Tariff Commission, has estimated that if all our tariffs and quotas were suspended it would mean an increase in our imports today of only \$800,000,000 to \$1,800,000,000 a year.

Nevertheless our British and other European friends have a case: and it would be well for us to heed it. It concerns immediately not so much the absolute level of our tariff as the uncertainties surrounding its future. A British manufacturer, for example, may hesitate to expand his output or sales for our market, as long as he fears that our customs officials may suddenly make some new adverse decision or that Congress may suddenly increase the tariff rate. So if any of us



may presume to anticipate the report of the Randall commission (which, judging from that body's composition, is likely to be split or ambiguous anyway) I should like to suggest that the President call upon the present Congress to pass a resolution pledging itself not to *increase* any import duty or impose any further quota restriction during its term. The worldwide economic and political effect of such an act could not fail to be wholesome.

Further measures would of course be desirable. The first of them would be to wipe out all our import quotas. And then we might do well to emulate what we did in the tariff of 1833. This provided for a gradual reduction of rates over ten years to a general level of 20 percent. Why couldn't we now, say, provide for a gradual reduction over ten or twenty years of all tariff rates above 20 percent down to that maximum level, with the sole exception of rates on items vital in time of war, the continued production of which could not be assured in any better way? ❁

## More about American Help

October 26, 1953

In this space last week I discussed some of the things that this country could do to help both itself and the world. My first proposal was that the President call upon the present Congress to pledge itself not to increase any import duty or impose any further quota restriction during its term. My second proposal was to wipe out all our import quotas. My third was to emulate the principle that we followed in the tariff of 1833, and provide for a gradual reduction over ten or twenty years of tariff rates above 20 percent down to that maximum level (with the possible exception of some items vital to defense).

The purpose of this last proposal would be to reduce the hardships of tariff readjustment to a minimum. As Prof. Yale Brozen has put it: "In moving toward free trade, we must reduce our tariffs slowly in order to give . . . those who have invested in skills and equipment specialized to our protected industries . . . the opportunity to depreciate their equipment and to adjust to the new situation." (See the "economic forum" pamphlet, *The Economics of Tariffs*, 112 pages, National Industrial Conference Board, \$1.)

It may be asked whether, instead of such a unilateral reduction of our tariffs, it would not be better to extend the reciprocal-trade-agreements program for a period of twenty years. Among the arguments of those

who favor this are that it would provide us with better leverage in getting tariff reductions from other nations and that more attention could be paid to the specific merits of each tariff rate. But the arguments against continuing the reciprocal-agreements program seem to me to outweigh these. For the program rests on the false tacit assumption that a reduction in tariff rates is primarily a favor to the other country's producers rather than to one's own consumers. And precisely because such a program does treat each rate on its own alleged merits, it makes every rate a source of special haggling, multiplies lobby pressures and the pull and tug of special interests, and violates the spirit of the most-favored-nation principle even when it adheres to it technically.

We are brought back once more to the question of foreign financial aid. The whole foreign-aid program from the beginning has rested on a false diagnosis of the ills of Europe and the "underdeveloped" countries and a false conception of the remedy. In practice, instead of inducing the beneficiary countries to return more quickly to sound policies and free enterprise, our aid has subsidized socialism and encouraged these countries to continue statist controls far longer than otherwise.

But the foreign-aid program can be terminated with less shock, and the proper reforms encouraged, if for a limited transition period our government would undertake to guarantee private loans to private foreign borrowers against political risks, especially against the risk of nontransferability of profits, along the lines and on the firm specific conditions suggested by F.A. Hayek in *The Freeman* of April 6. This program, however, should in no case be in *addition* to present foreign governmental aid, but as a short-lived *substitute* for it, to ease adjustment to a free system.

At the very beginning of the Marshall Plan, our government could have obtained far more results with far less money if it had offered to make loans solely for currency stabilization on strict conditions of eligibility.

But the time for that has now passed. If a government fails or refuses to follow sound monetary, fiscal, and economic policies, no foreign loan can be large enough to do any permanent good. Its proceeds would only be drained away as were those of our \$3,750,000,000 loan to Britain in 1946. If, on the contrary, a country follows sound monetary, fiscal, and economic policies, it can get private loans if it needs them, and is unlikely to need any outside governmental help at all. Perhaps the worst result of our whole foreign-aid program has been to divert attention away from the measures a country must take to help itself and to stand on its own feet. ❁



## In the Sweet By and By

November 2, 1953

Just before the Republican convention of 1952, General Eisenhower expressed the opinion that the Federal budget could be cut as much as \$40,000,000,000 in the next few years. In his State of the Union message on Feb. 2 of this year he said: "The first order of business is the elimination of the annual deficit." But he has successively explained that he could not balance the budget for the 1953 fiscal year, or for the current 1954 fiscal year. On Oct. 12 his Director of the Budget, Joseph M. Dodge, warned: "The budget-balancing problem in the 1955 fiscal year is at least the same in magnitude as the one we faced this year."

This pattern, in which the budget is going to be balanced by and by, but of course not now, is ominously reminiscent. Let us recall some statements by Franklin D. Roosevelt:

"The plan is to reduce the cost of current Federal government operations by 25 percent."—Oct. 19, 1932.

"For three long years the Federal government has been on the road toward bankruptcy. . . . [By the end of the fiscal year 1934] we shall have piled up an accumulated deficit of \$5,000,000,000. . . . Too often in recent history liberal governments have been wrecked on the rocks of loose fiscal policy. . . . I give you assurance that if this [passing of the economy act] is done, there is reasonable prospect that within a year the income of the government will be sufficient to cover the expenditures of the government."—March 10, 1933.

"We should plan to have a definitely balanced budget for the third year of recovery and from that time on seek a continuing reduction of the national debt."—Jan. 4, 1934.

"We can look forward with assurance to a decreasing deficit."—Nov. 29, 1935.

"We approach a balance of the national budget. National income increases; tax receipts, based on that income, increase without the levying of new taxes."—Jan. 3, 1936.

"If [the national income] keeps on rising at the present rate, as I am confident it will, the receipts (of the government) . . . within a year or two, will be sufficient . . . to balance the annual budget."—Oct. 1, 1936.

"The Treasury is all right and we are balancing that budget—you needn't worry."—Oct. 3, 1937.

"It has taken courage for the Federal government to go into the 'red' . . . but it has been worth it."—July 8, 1938.

"I here and now prophesy: That the Republican leadership, conservative at heart, will seek to run with the hare and hunt with the hounds, talking for balanced budgets out of one side of its mouth and for opportunist raids on the Treasury out of the other. . . . —Jan. 7, 1939.

"For several years we have been compelled to strengthen our own national defense. That has created a very large portion of our Treasury deficits."—Jan. 4, 1940.

And here are a couple of statements from Harry S. Truman:

"The budget for the fiscal year 1949 calls for total expenditures of \$39,700,000,000. Receipts during this period are estimated under existing tax laws at \$44,500,000,000. This will balance the budget and provide \$4,800,000,000 which should be used to reduce the public debt."—Jan. 12, 1948. (There was actually a deficit of \$1,811,440,000.)

"In a period of high prosperity it is not sound public policy for the government to operate at a deficit. A government surplus at this time is vitally important. . . . I am, therefore, recommending new tax legislation. . . ."—Jan. 10, 1949. (The deficit for the fiscal year 1950 was \$3,122,102,000.)

Space forbids further quotations, but the reader, I am sure, gets the idea. Each President began with pious promises of a budget balance, but there were always reasons why this could be done only in some indefinite future, and not now. Meanwhile, the national debt keeps mounting and the purchasing power of the dollar keeps shrinking and a Republican budget director is warning against "the disturbing effects on the economy" of spending cuts that are "too abrupt." Isn't this where we came in? ❁

## Myth of Perpetual Boom

November 9, 1953

The air is full of talk of "recession," and yet we are still close to what is so far the highest point in the greatest inflationary boom in our history. Look at some of the figures in the latest monthly statistical report of the President's Council of Economic Advisers. In July, August, and September of this year the country's gross national product—its total output of goods and services—was running at the tremendous annual rate of \$371,000,000,000. This was a slight shade under the rate of \$372,400,000,000 in the preceding quarter, but

was otherwise the highest on record, comparing with \$348,000,000,000 in 1952 and (just for one flashback) with \$91,300,000,000 in 1939.

Other comparisons conform. Employment in the third quarter was at the highest level in our history—63,000,000. Unemployment was estimated at only 2 percent of the labor force. Average hourly wages in manufacturing, at \$1.77, were also at a record high. So were estimated annual corporate profits before taxes.

Why, then, all the jittery talk about recession? Apparently because every index is not at an absolute peak. Net farm income this year is estimated at about \$12,500,000,000, as compared with a postwar average of \$14,500,000,000. Cattle raisers, it is true, have been hit hard. But what leads such a situation to be discussed as a sort of national crisis, calling for immediate action at the public expense, is a new ideology.

The assumption seems to run through most public discussion today that we must never tolerate or permit a recession or a readjustment in *anything*. The reason so many of us talk this way is that we have become convinced that we now know how to prevent depressions or recessions and there is no excuse for not doing so. This explains such statements as President Eisenhower's: "Never again shall we allow a depression in the United States."

But do we in fact know how to prevent any future depression or to curb any present recession? Certainly the most popular assumption about how this can be done is wrong. It is assumed that what principally determines the level of economic activity is the volume of government spending. But if Federal spending were slashed from \$72,000,000,000 a year to \$50,000,000,000, for example, *and if taxes were cut correspondingly*, the taxpayers would have as much more to spend as the government had less. What would take place, other conditions remaining unchanged, is not a decline in total demand but a shift from a demand for defense items and governmental goods and services to a demand for more civilian goods and services.

If the absolute level of government spending determined the issue, then there would have been a huge depression when Federal spending dropped from \$98,700,000,000 in the fiscal year 1944–45 to \$60,700,000,000 in the fiscal year 1945–46, and a still worse depression when it fell to \$39,300,000,000 in 1946–47. Here was a drop of nearly \$60,000,000,000 in the rate of government spending within a two-year period. Yet instead of there being a depression, employment and national income rose.

What has produced these ever-rising monetary totals, these miracles of national income and prosperity, has been, simply, inflation. This is sufficiently pointed up by the new record-high level in the cost of living. The inflation has been brought about by continuous budget deficits (not the same as the volume of spending) and, more directly, by the continuous increase in the supply of money.

But inflation is not a guaranteed way of keeping full employment and averting a recession. On the contrary, it "works" only as long as prices keep ahead of costs and maintain profit margins. If wages shoot ahead of prices, there will be unemployment in spite of inflation. And inflation, contrary to present popular assumption, cannot be "planned" or controlled. Sooner or later it gets out of hand. Those who, under the pretense of "preventing deflation," would try to keep the inflationary boom whipped up to new peaks, are recklessly playing with fire. ❀

## Is Depreciation a Subsidy?

November 16, 1953

Most socialists and left-wingers have few scruples about the kind of argumentative weapons they use in their attacks on private business. But some charges are sillier than others, and one of the silliest is that "accelerated amortization" constitutes a government "subsidy" to business and a sort of scandal. I would have supposed, to cite only one example, that the speech on the subject by Irving S. Olds, chairman of the board of the United States Steel Corp., on May 3, 1951, would have permanently silenced this nonsense. But as late as a few weeks ago Gordon R. Clapp, chairman of the Tennessee Valley Authority, was still repeating it in all its original impurity.

"Perhaps you have heard," he told the Memphis Kiwanis Club on Sept. 30, "of tax certificates for accelerated amortization." These, he went on, constitute a "big bonanza," a "magic Federal-aid program," "interest-free loans from the taxpayer," and, in short, government "subsidies" for the private utilities.

He demanded an "explanation" of them, and so I offer one. All plants, machines, and equipment in time either become obsolete or wear out. Suppose a machine costs \$1,000 to install and has a probable useful life of ten years. Then the man who owns it ought to deduct, say, \$100 a year from his apparent profits on the machine, and set this money aside. At the end

of ten years, if his estimate of the useful life of the machine has been correct, he will have deducted a total of \$1,000 as an allowance for depreciation, and he will have this amount to replace the old machine that has become useless. If he has not been making this book-keeping deduction he has been deceiving himself as to the amount of his real profit. If he has not set aside the funds to replace the machine he may find himself out of business.

Now the tax-collecting Internal Revenue Bureau has been very strict regarding the annual rate at which it permits a company to write off depreciation. But under the Revenue Act of 1950, in order to encourage companies to put up new plants deemed essential to the defense program, Congress permitted them to "write off" such plants within a period of five years.

This privilege offered only one advantage to the company that obtained it. If the defense emergency lasted for only five years, and the new plant became useless at the end of that time through lack of orders, at least the company would not have been paying taxes on profits that turned out to be fictitious because they did not allow enough for the loss on the investment. Otherwise a company stands to benefit from the privilege only on the assumption (disappointed after the second world war) that the corporate tax rate will be lower after the specified five-year amortization period than during it.

In the vocabulary of the Clapps, of course, whenever the government seizes less in taxes from you, even temporarily, than it did before, you are being "subsidized" by it. But even by this reckless perversion of words it is hard to see how permission for a shorter amortization period can be called a "subsidy." For a facility can not be depreciated by more than 100 per cent of its value, and it can only be depreciated once. Whether a \$1,000 machine is depreciated over one year or over twenty, only \$1,000 in all can be deducted, and if the same rate of tax is levied over the whole period, the same total tax is paid to the government.

There is in fact an inequity in the depreciation rules of the Internal Revenue Bureau, but it is exactly the opposite of what Clapp contends. It consists in allowing corporations to deduct only against original investment and not against cost of replacement. A machine bought at \$1,000 in 1939 would probably cost more than \$2,000 to replace today. In a period of inflation, industry that is allowed to deduct depreciation only against original costs, and not against cost of replacement, is paying taxes on profits that are illusory when measured in real terms. The real tax rate is even greater than the nominal rate, and capital consumption is concealed. ❁

## For a Responsible Budget

November 23, 1953

The Administration is being forced to adopt all sorts of expedients to keep from breaking through the debt limit of \$275,000,000,000. This does not prove that Congress was wrong in refusing last summer to grant immediately the President's request for an increase in the debt limit to \$290,000,000,000. The postponement has not reduced spending, but it has at least drawn increased attention to its prodigious rate and to the continuation of huge deficits and borrowing. And to act as a warning signal is, in fact, the chief function that a legal debt limit can serve.

The Administration will be forced to go again to Congress for an increase in the debt limit, and Congress now has no alternative but to grant it. But it would be folly to grant it without some *quid pro quo*. The minimum condition (which could be tied to the debt-increased authorization) should be the Coudert resolution or its equivalent. This would prohibit the Administration from spending more than it took in during any year except in time of war or of a grave national emergency declared to be such by a two-thirds vote of each house of Congress.

But even this measure would be only a stopgap. What is now imperative is a responsible budget system: Today the House of Representatives has the power to increase expenditures beyond those proposed by the President, and the Senate has the power to increase expenditures beyond those voted by the House. The result is a three-way competition in extravagance.

The only fundamental cure for this situation would be to adopt the wholesome British rule under which the Legislative branch may reduce, but cannot increase, the total expenditures proposed by the Executive branch. One of the foremost functions of a representative assembly is to act as watchman of the Treasury, and it cannot be depended on to perform that function as long as it is free to put its own hands in the Treasury.

The constitutional revision which this would imply probably goes beyond what Congressional or public opinion today is prepared to accept. But there are changes which have already been successfully tested in many of our states and which would at least bring us much closer to full budget responsibility.

We may cite as one example the kind of budget procedure that prevails in New York State. Under this system the governor's annual budget must not only give estimated expenditures and revenues for the next fiscal year, but must be accompanied by a bill or bills



containing all the proposed appropriations and any proposed new taxes.

The legislature (I quote the state constitution) “may not alter an appropriation bill submitted by the governor except to strike out or reduce items therein. . . .” Further: “Neither house of the legislature shall consider any other bill making an appropriation until all the appropriation bills submitted by the governor shall have been finally acted on by both houses. . . .” If the legislature wishes to increase or add any appropriation, it must be by separate items or bills “each for a single object or purpose” which “shall be subject to the governor’s approval.” And the New York constitution gives the governor explicit power to do what the President cannot do—veto individual items in appropriation bills.

Congress would probably be unwilling to submit a constitutional amendment to give the President these budgetary powers, unless it got in return added budget powers of its own. In such an amendment, therefore, it might give itself the explicit power to return an unbalanced budget submitted by the President with directions either to balance it or to reduce his proposed total expenditures to some specific maximum.

The basic principle to be followed to attain a responsible budget system is clear. It is to reduce the power of either Congress or the President to spend without restraint and to increase the power of both Congress and the President to limit the spending of the other. ❁

## White’s Mischief Lives On

November 30, 1953

In his *Newsweek* column of last week my colleague Raymond Moley described some of the irremediable harm that had been done to the United States and the world through the influence of Harry Dexter White. But White fathered one institution that is still with us, and still working immense harm—the International Monetary Fund.

Some of us have repeatedly called attention to the harmfulness of the fund since the day of its conception. In the *Newsweek* of Dec. 31, 1951, for example, I wrote: “The chief remaining obstacle to a world restoration of freedom and sound money is the International Monetary Fund, an unnecessary institution set up, under the influence of the late Lord Keynes and Harry Dexter White, on a completely unsound basis.”

But the analyses of myself and others fell on deaf ears, chiefly because of the myth that the fund was the product of the objective judgment of the world’s monetary experts. Actually, the experts from other countries

were in fact government bureaucrats who approved it on the principle that it involved a huge American handout and that you don’t look a gift horse in the mouth.

The story of the part that White played in the formation of the fund is described in R.F. Harrod’s biography of John Maynard Keynes, published in 1951.\* In the light of what we now know about the real aims of White it makes fascinating reading.

In America during the second world war, writes Harrod, there was active discussion of postwar economic problems, “indeed quite an intellectual ferment. In this the central figure was undoubtedly Harry White. . . . He was a very remarkable figure, who should be accorded an honorable place in British annals. . . . When Mr. Morgenthau became Secretary of the Treasury in 1934 he asked Prof. [Jacob] Viner to undertake a study of Treasury problems. Among the economists whom Viner brought in was Harry White. . . . He won the confidence of Mr. Morgenthau. His influence in the Treasury was always more important than the post which he held. . . . During the second [world] war he became the leading figure in the Treasury.

“He . . . was an ardent admirer of Keynes’s economic work; he also had great practical energy and a forceful personality, which could readily dominate a committee. He was blunt and downright in speech, and also fervent. . . . His influence came to extend beyond the Treasury. He made enemies. In his determination to get his way, he adopted methods which might be labeled those of an intriguer. He was distrusted in the banking world, and also by some seasoned public servants. He gained the reputation of being a difficult man to deal with. But he was single-minded in the pursuit of his aims. He was a reformer of genuine conviction.” Harrod lists as among White’s supporters Frank Coe and Lauchlin Currie. “It is probably true to say that but for White’s assiduity and galvanic personality a large scheme of the kind for which Keynes was working in Britain would never have come to birth at Bretton Woods.”

And what was this scheme? It was extremely ambitious, not to say grandiose, and Harrod is lost in admiration of it. “This American group [under White] also produced a bulky volume, which, however, was not a sandwich with a thin layer of internationalism in the midst of it, but all solid internationalism.” It certainly was. It proposed to solve every other nation’s problem at the expense of the American taxpayer. It gave “rights” to other nations to exchange their currencies, at rates far above their market value, for American dollars. It adopted the shiny new White-Keynesian



principle (really what debtors have always suspected) that if the debtor can not repay the creditor it must be at least partly the creditor's fault, and the creditor should be punished for it. The creditor was expected to be, of course, the United States, and the main debtor, England.

And it was finally White who drafted the "American" proposal that "if creditor countries increase their credit beyond a [certain] level, their currencies would be declared 'scarce' and would be allotted under a scheme, and thus debtor nations would have a fully authorized right to discriminate against the exports of the creditor countries."

"This," correctly declares the British economist Harrod, "was a very remarkable concession. If the United States was really to maintain over a term of years the oppressive role of creditor, which all predicted for her, it would mean that she was by this clause authorizing other nations to discriminate against the purchase of American goods . . . and to maintain their own full employment in the presence of an American depression."

In fact, when Harrod first read this concession he "felt an exhilaration such as only comes once or twice in a lifetime. . . . Here is the real thing, because it will save us [England] from a slump." He wrote immediately to Keynes: This "gives us [the British] what we should never have dared to ask for or hoped to get . . . namely, that we (and other countries) should be allowed to discriminate against American goods if dollars are running short. . . . From now on our main object should be to hold the Americans up to the principles of S.F.7 [the concessions]." Keynes in reply expressed doubt that the State Department realized what was being given away by "this document of Harry White's" and thought it would withdraw approval as soon as it did.

But, triumphantly concludes Harrod in his account: "The Americans did not run out. The scarce-currency clause was incorporated, in a much stronger form than it had in the original draft, in the Bretton Woods Act passed by Congress in July 1945."

So that was how the IMF and its principles were put over. And in his farewell speech at the Bretton Woods conference, Keynes, speaking for England, was not ungrateful: "I am certain that no similar conference within memory has achieved such a bulk of lucid, solid construction. We owe this not least to the indomitable will and energy . . . of Harry White."

\* *The Life of John Maynard Keynes* (Harcourt, Brace, 674 pages, \$7.50). ❁

## European Isolationism

December 7, 1953

It is hard to see how the seventeen-member Randall Commission on Foreign Economic Policy, composed both of protectionists and low-tariff spokesmen, can possibly turn in a unanimous report. But if it is looking for sensible and practical compromise proposals on which a substantial majority might unite, I recommend its earnest attention to the suggestions put forward by Juan T. Trippe, president of Pan American World Airways, Inc., at the recent convention of the National Foreign Trade Council. Trippe proposes extension of the Reciprocal Trade Agreements Act for two years; repeal of the Buy America Act; further customs simplification along the lines of the Jenkins bill, and encouragement of private investment abroad by permitting the President "to conclude reciprocal treaties with other nations, exempting income earned abroad from domestic taxes."

I should personally prefer, of course, to see the Randall report go much farther than this in the direction of lowering tariff rates and other trade barriers. In fact, I should regard as more urgently necessary than any of Trippe's proposals the total abolition of our present import quotas.

But while Trippe's practical suggestions are all in the right direction, his assignment of blame for the present world-trade situation, like that of so many other Americans, is oddly one-sided in its self-reproachfulness: "Many Americans are still isolationists in their economic thinking. . . . Much of our past world-trade policy makes little sense. . . . Twenty-five years ago, our imports amounted to 5 percent of the annual value of our national income. . . . Today, with the rest of the free world in need of dollars to buy our goods and products, our imports are but 3 percent. A generation ago, when Great Britain was the world's great creditor nation, her businessmen invested abroad each year some 2.5 percent of her national income. Today, we Americans invest abroad but 1/3 of 1 percent."

The implication here is that this comparative situation is solely or chiefly America's fault. It is chiefly, on the contrary, the fault of Europe and the rest of the world. Bad as our international economic policies have been in some respects, those of most European and Asian countries have been incomparably worse. Their exchange controls, artificial currency valuations, bilateralism, import quotas, license requirements, and direct prohibitions, not to speak of their network of internal restrictions, have done far more to throttle two-way trade than the American tariff barrier. Indeed, at one point Trippe himself points out that our average tariff

rate of 5 percent on total imports compares with an average of 13 percent on total imports for the fifteen Western European countries. Even when tariff barriers are considered merely by themselves, in other words, ours may be less restrictive.

And our comparatively small amount of foreign private investment is certainly far more the result of hostility to private capital in the would-be borrowing countries—with their confidence-destroying policies, such as vexatious laws, excessive taxation, exchange control, currency inconvertibility, and outright expropriation—than of any lack of eagerness of Americans to invest abroad. In fact, as long as these foreign countries get American taxpayers' money as a gift, they do not *need* to pay for their imports from us with equivalent exports to us. And as long as these foreign countries get American taxpayers' money as a gift they have far less need to make the reforms necessary to attract *private* American capital.

The greatest barrier to a free flow of international trade today, in brief, is not American economic isolationism but European economic isolationism and Asian economic isolationism. That most of Europe, following more isolationist policies than at any time since the seventeenth century, should have succeeded in turning the isolationist charge primarily against us, is certainly not the least remarkable example of the Alice-in-Wonderland ideological climate of the present age. ❁

## Resumption of Inflation

December 14, 1953

The Eisenhower Administration, which so bravely abolished price controls and made such a promising effort to halt inflation when it first came into office, has reversed its direction. It seems to have embraced almost the whole economic philosophy of the New Deal, and above all its policy of continuous inflation. And it has resumed this policy under the old New Deal-Fair Deal pretense of "fighting deflation."

The turnabout first became apparent in mid-May, when the Federal Reserve System began purchasing Treasury bills in the open market. Then on June 24 came the much stronger inflationary step of reducing the reserve requirements of member banks. This action was taken to release \$1,156,000,000 of reserves in order to give the country's banks another \$5,780,000,000 in lending power. This was frankly done in anticipation

of Treasury needs of some \$6,000,000,000 of "new money."

The action had the hoped-for results. In the month of July alone the total loans and investments of the nation's banks were increased by \$4,700,000,000. The country's money supply (total bank deposits plus currency outside of banks) increased by about the same amount. At the end of September the nation's money supply stood at the record high level of \$204,900,000,000. This was three times the money supply at the end of 1939.

As a result of this policy, interest rates were brought down again. In the week ended Nov. 28, three-month Treasury bills sold to yield only 1.488 compared with a yield of 2.231 in June. Commercial borrowing rates were correspondingly lower, thus encouraging business to borrow more. As of Oct. 15, the cost of living rose for the eighth month in a row, and to a new high level.

In recent weeks, and especially since the Republican Congressional defeat in Wisconsin, there have been increasingly unmistakable signs of a decision in the White House to resume inflation. Secretary Benson has to all but a minor extent capitulated to the extreme farm-price-support demands in Congress. A few weeks ago William D. Mitchell was suddenly fired as head of the Small Business Administration. His chief crime seemed to be that he had been cautious in his lending policies, and tried to save the taxpayers money. Immediately after he left, the SBA indicated that government loans would be available to almost any type of business, not just to defense contractors or "essential" producers.

Then on Nov. 18 President Eisenhower announced at his press conference that the Administration had given up all hope, not only of balancing the budget in the present fiscal year, but even in the fiscal year 1955. He also declared that "when it becomes clear that the government has to step in . . . the full power of government, of government credit, and of everything the government has will move in to see that there is no widespread unemployment."

The *Wall Street Journal*, in a news story the next day, declared that this statement was not merely offhand, because the Eisenhower Administration was hammering out, for use "when and if needed," an elaborate "antirecession program." This included all the usual Federal Reserve devices for loosening credit—lowering bank-reserve requirements and rediscount rates, and the purchase of government bonds. In addition, the story ran, seven "task forces" were working under Dr. Arthur Burns, chairman of the President's Council of Economic Advisers, to study Federal credit insurance for home modernization and repair, liberalization of

unemployment insurance, Federal aid to new construction, tax relief, public works, and the “whole field of community and private business planning.” Finally, private financial institutions, such as banks and insurance companies, were “being eyed to see where they fit into depression-fighting schemes.”

Most of these “depression-fighting schemes” seem to me to bear a striking resemblance to the New Deal’s inflationary devices, and its philosophy of “spend and spend, elect and elect.” But I could be wrong, and I hope I am. ❁

## Our Blind Labor Laws

December 21, 1953

What has to happen in order to awaken the American public and its representatives in Congress to the unreality, hypocrisy, and blindness of our present labor laws?

If facts and crises are capable of teaching anything, New Yorkers, at least, have just received an intensive educational course. A few weeks ago workers in the milk industry decided to shut off the milk supply for 12,000,000 men, women, and children in the New York district until their demands were met. Meanwhile their pickets held up trucks, dumped milk, or poured kerosene over emergency shipments for schools and hospitals. Next, the New York newspapers were hit by a photoengravers’ strike. These photoengravers were getting \$120 to \$131 for a basic week of 36¼ hours. Some of them, with overtime, earned as much as \$10,000 a year. But they demanded a \$15 weekly increase and a 32-hour week and refused the publishers’ offer of arbitration.

The photoengravers have only about 400 men in their union. It would have been easily possible to publish newspapers without them. But they threw picket lines in front of the newspapers, and other unions decided to “respect the picket lines.” The result was that practically the whole New York daily press was shut down for eleven days.

This situation, it is true, brought forth some indignant comment about labor-union dictatorship. It was pointed out that the decision of other unions to “respect picket lines” was tantamount to a sympathy strike of their own in violation of contract, and that the constitutional right of the press to publish without restraint had been infringed by irresponsible private groups.

Yet when it came to ways of preventing the recurrence of such a situation, what was mainly heard was demands for still more legal coercion. *Editor & Publisher*, the industry’s magazine, spoiled an otherwise excellent editorial by calling for a prohibition of strikes

and “mandatory arbitration” in “any communications industry.” But mandatory arbitration is merely another name for government wage-fixing. It leads inevitably to complete abolition of a free-enterprise system. And it is hard to see any more reason why newspaper strikes should be prohibited than, say, milk strikes.

What is really needed is a complete reexamination of the basic assumptions and actual effect of our present labor law. The Taft-Hartley Act, like its predecessor the Wagner Act, of which it is merely an amendment, abridges the employer’s freedom to bargain, to hire, and to fire. The ability of the unions to deprive New York’s millions of families of milk and newspapers was made possible by the Taft-Hartley Act. Under that act the milk companies were compelled to bargain solely with the striking milk drivers’ union; and the newspaper publishers were compelled to bargain solely with the local AFL photoengravers’ union. Both sets of employers were legally prohibited from “recognizing” or bargaining with any other union or with individuals.

And this Federal law is supplemented and supported by local police action that enforces the picket line rather than the right to work. But mass picketing, whatever its pretenses to “peaceful persuasion,” is a device for intimidation. For customers, to “respect the picket line” is to support the strike. For employees, to “respect the picket line” is to participate in the strike. And to argue that all picket lines must be respected is to argue that all strikes must be supported, regardless of their individual merits.

But the right to strike does not necessarily imply the right to win a strike, and the right to quit work does not imply the right to prevent others from working. The way out of the present union dictatorship is not compulsory arbitration, but repeal of the Taft-Hartley Act (or removal of its abridgements of the right of either workers or employers to associate or not to associate) and local enforcement of the common law against intimidation and violence. ❁

## The Ethics of Picketing

December 28, 1953

Last week, in connection with the New York milk and newspaper strikes, I pointed out that mass picketing, however much it may pretend to be “peaceful persuasion,” is a device for intimidation, and that the right to quit work does not imply the right to prevent others from working. But these elementary propositions are forgotten or denied today by our labor laws and by our



courts. And as long as they are denied we will have union-boss dictatorship and chaotic labor relations.

A typical case was brought to light in New York by a decision of the Appellate Division on Dec. 15. It involved the picketing of a retail liquor store that has been going on for two years. In October 1951, a union tried to enroll the three sales clerks of the store. They refused to join. Thereupon a picket line, with signs intimating that the employer was unfair to union labor, was placed in front of the store. Even after two years of this exhortation, the clerks refused to join the union.

The proprietor, Sydney J. Wood, then petitioned the New York State Labor Relations Board for an election to determine whether the union represented his employees. At that time the union made no claim to represent any of the employees. Yet Wood's petition was dismissed by a vote of 2 to 1 on the ground that the union was engaged in organizational activity. The New York Supreme Court later dismissed his complaint on the same ground.

Now New York's Appellate Division has reversed this decision. "The conclusion is inevitable," it declares, "that the picketing here included an unlawful objective in that it sought to coerce the employer into signing a contract with the union, and as it was doing so by exerting economic pressure against the employer in order to force him to violate the State Labor Relations Act by compelling the employees to join the union against their will or, in the alternative, to drive the plaintiff out of business, plaintiff . . . is entitled to the relief he seeks."

It is important to notice, however, that this decision did not grant the employer relief because he was being coerced, but because he was being coerced into violating the state labor law. The recent trend of Federal decisions

has not been such as to discourage coercive picketing. On Dec. 14, for example, the U.S. Supreme Court handed down two decisions which in conjunction make it almost impossible for the states to enforce sensible laws on picketing. The court ruled in one case that franchised automobile dealers come under the Taft-Hartley Act even when their own automobile buying and selling are wholly within a single state. Under such fantastically extended interpretations of the Constitution's interstate-commerce clause, it is hard to see what important powers over labor relations and local labor peace will remain to the states and cities. In another Dec. 14 decision, in fact, the Supreme Court ruled that states cannot enforce their own antipicketing laws even when these laws coincide with the Taft-Hartley Act.

Mass picketing is commonly defended on the ground that it is merely a peaceful exercise of the right of free speech—a notice to the public that a strike is going on and that the employer is "unfair." But this purpose could be amply secured if the police permitted, say, no more than two pickets to an entrance. If the police and the law and the labor boards permit a picket line of a hundred, on the other hand, yelling abuse and insults at customers and at workers who continue on the job, then in all consistency they should allow the employer to hire an equally large picket line to yell back counter-statements. Their failure to do so exposes the hollowness of the "free speech" argument. In many cases today, in fact, the police enforce the picket line rather than the right to work. It is the people who try to get through the line who are accused of disturbing the peace.

Peaceable and balanced labor relations are most likely to come through the repeal or drastic revision of the Taft-Hartley Act and local enforcement of the common law against coercion, intimidation, and violence. ☸





1954



## Why Return to Gold?

January 4, 1954

Forty years ago practically every economist of repute supported the gold standard. Most of the merits of that standard were clearly recognized. It was, for one thing, international. When the currency unit of nearly every major country was defined as a specified weight of gold (previous to 1934 the American dollar, for example, was defined as 23.22 grains of fine gold) every such currency unit bore a fixed relation to every other currency unit of the same kind. It was convertible at that fixed ratio, on demand, to any amount, and by anybody who held it, into any other gold currency unit. The result was in effect an international currency system. Gold was the international medium of exchange.

This international gold standard was the chief safeguard against tampering with the currency on the part of politicians and bureaucrats. It was the chief safeguard against domestic inflation. When credit inflation did occur, it produced a quick sequence of results. Domestic prices rose. This encouraged imports and discouraged exports. The balance of trade shifted “against” the inflating country. Gold started to flow out. This caused a contraction of the bank credit based on the gold, and brought the inflation to a halt.

Usually, in fact, the chain of consequences was shorter, quicker, and more direct. As soon as foreign bankers and exchange dealers even suspected the existence of inflation in a given country, the exchange rate for that country’s currency fell “below the gold point.” Gold started to flow out. Then the central-bank managers of the country that was losing gold raised the discount rate. The effect was not merely to halt credit expansion at home, but to draw funds from abroad from lenders who wanted to take advantage of the higher short-term interest rates. The gold flow was stopped or reversed.

Thus so long as the gold standard was resolutely maintained, a whole set of related benefits ensued. Domestic currency tampering and anything more than a relatively moderate inflation were impossible. As gold convertibility had to be maintained at all times, confidence had to be maintained not only through every year but every day. Unsound monetary and economic policies, or even serious proposals of unsound policies, were immediately reflected in exchange rates and in gold movements. Unsound policies or proposals had to be quickly moderated or abandoned.

Because there was a fixed and dependable exchange ratio as well as free convertibility between one currency unit and another, international trade, lending,

and investment were undertaken freely and with confidence. And, finally, the international gold standard established (apart from differences caused by shipping costs and tariffs) uniform world prices for transportable commodities—wheat, coffee, sugar, cotton, wool, lead, copper, silver, etc.

It has become fashionable to say that in a major crisis, such as war, the gold standard “breaks down.” But except to the extent that the citizens of a country fear invasion, conquest, and physical seizure of their gold by the enemy, this is an untrue description of what happens. It is not that the gold standard “breaks down,” but that it is deliberately abandoned or destroyed. What the citizens of a country really fear in such crises is inflation by their own monetary managers, or seizure of their gold by their own bureaucrats. This inflation or seizure is not “inevitable” in wartime; it is the result of policy.

In short, it is precisely the merits of the international gold standard which the world’s money managers and bureaucrats decry. They do not want to be prevented from inflating whenever they see fit to inflate. They do not want their domestic economy and prices to be tied into the world economy and world prices. They want to be free to manipulate their own domestic price level. They want to pursue purely nationalistic policies (at the expense or imagined expense of other countries), and their pretenses to “internationalism” are a pious fraud. ☸

## Gold Means Good Faith

January 11, 1954

Nothing has more clearly demonstrated the need for the gold standard than its abandonment. Since that occurred, in Britain in 1931 and here in 1933, the world has been plunged, both in wartime and in peacetime, into a sea of paper money and unending inflation.

While the inflation everywhere has been blamed on “the war,” it has occurred in nations that were never involved in the war (throughout Latin America, for example), and it has continued to rage since the war ended. As an indirect index of this, wholesale prices have increased in this country 60 percent since 1945; in Britain 92 percent; in France 600 percent. And everywhere this result has been due primarily to the increase in the paper-money supply.

The monetary managers are fond of telling us that they have substituted “responsible monetary management” for the gold standard. But there is no historic record of responsible paper-money management. Here and there it is possible to point to brief periods of a



“stabilization” of paper money. But such periods have always been precarious and short-lived. The record taken as a whole is one of hyperinflation, devaluation, and monetary chaos. And as for any integrity in paper-money management, we need merely recall the record of Sir Stafford Cripps, who, in the two-year period preceding his devaluation of the pound sterling on Sept. 18, 1949, publicly denied any such possibility no fewer than a dozen times. (The record was cited in this column in *Newsweek*, Nov. 21, 1949.)

This is what happens under monetary management without the discipline of the gold standard. The gold standard not only helps to insure good policy and good faith; its own continuance or resumption requires good policy and good faith. The gold standard is not important as an isolated gadget but only as an integral part of the whole economic system. Just as “managed” paper money goes with a statist and collectivist philosophy, with government “planning,” with a coercive economy in which the citizen is always at the mercy of bureaucratic caprice, so the gold standard is an integral part of a free-enterprise economy under which governments respect private property, economize in spending, balance their budgets, keep their promises, and above all refuse to connive in inflation—in the overexpansion of money or credit.

So if, as it should, the government decides to return to a full gold standard, its first step must be to bring inflation to a halt. Without this preliminary or accompanying step any attempted return to gold would be certain to collapse. And once again the gold standard itself, rather than the inflation, would probably be discredited in the popular mind.

How, then, does one halt inflation? The economist Ludwig von Mises has maintained that no increase whatever should be allowed in the quantity of money and bank credit that is not 100 percent covered by deposits paid in by the public. While this is basically the result that should be aimed at, it would be politically more acceptable, I think, if this result were brought about by means in accordance with our own best practices and past traditions. I therefore suggest that the halting of inflation should be achieved by these four means:

1—Start balancing the budget.

2—Stop using the banking system to buy and peg government bonds at fixed rates. In fact, the total volume of government securities held by the country’s banking system should not be increased.

3—Insist that the Federal Reserve Banks impose discount rates that would penalize borrowing by member banks rather than make it profitable. This means

that the rediscount rate should be kept above the rate to prime borrowing customers at the great city banks.

4—Restore the legal reserve requirements of the Federal Reserve Banks to 40 percent from their present “war emergency” reserve requirement of only 25 percent. There is no more effective way in which Congress could register its own opposition to further inflation—if it really is opposed to further inflation. ❁

## What Price for Gold?

January 18, 1954

Granted that it is desirable, and even imperative, to return to a full gold standard, by what methods should we return? And at precisely what dollar-gold ratio—i.e., at what “price for gold”? These difficult problems have split into dissident groups even the minority of economists who are actively urging a return to a gold standard.

One group, for example, contends that we can and should return to a full gold standard immediately, and at the present price of \$35 an ounce. It bases this contention on the arguments that we are already on a limited gold standard at that rate (foreign central banks, at least, are permitted to buy gold from us and sell it to us at \$35 an ounce); that we should not suspend this limited gold standard even as a transitional step for a few months; that in the interests of good faith and stability there should be no “further tampering” with this rate; and that at this rate we would in fact have a large enough gold reserve to maintain full convertibility against present outstanding paper currency and deposit liabilities.

These arguments, however, rest on debatable assumptions. Some superficial comparisons, it is true, seem to support them. At the beginning of 1933, the United States money supply (time and demand bank deposits plus currency outside of banks) was \$44,854,000,000, and the country’s gold holdings (measured at the old rate of \$20.67 an ounce) were \$4,237,000,000, or only 9.4 percent of the country’s money supply. Today our outstanding money supply is \$205,400,000,000, and our gold holdings against it (measured at the current rate of \$35 an ounce) are \$22,100,000,000, or 10.7 percent.

Thus our gold reserve situation appears on the surface to be as good as that in 1933. But do such comparisons really prove anything? Let us remember, first, that we were thrown off gold in 1933. (Or, more accurately, we had the choice of going off gold, which we did, or suffering still further deflation.) The run on gold in

1933, before payments were suspended, means that the gold reserves were not in fact sufficient, in relation to other conditions, to maintain confidence.

These comparisons overlook, moreover, that prior to 1933 the United States held a much smaller percentage of the world gold supply than it holds today. In December 1926, the United States held only 45 percent of the world's monetary gold supply (excluding Russia); in December 1933 it held only 33.6 percent. Today it holds 60.8 percent. If the United States alone returned to gold it could conceivably continue to hold this abnormal percentage for a certain time. But if other countries followed suit within a few years (which would be both desirable and probable), they would presumably attract their previous proportion of the world's gold. If our own supply were forced back to, say, 40 percent, our reserves would be drawn from the present \$22,100,000,000 to only \$14,600,000,000. This would leave us with gold reserves against present liabilities of only about 7 percent.

But the real error of those who think we could safely return to a full gold standard at a rate of only \$35 an ounce lies in the assumption that there is some fixed "normal" percentage of gold reserves to outstanding money liabilities that is entirely safe under all conditions. This, in fact, is not true of any gold reserve of less than 100 percent. In periods when public confidence exists in the determination of the monetary managers to maintain the gold standard, as well as in the prudence and wisdom of their policy, gold convertibility may be maintained with a surprisingly low reserve. But when confidence in the wisdom, prudence, and good faith of the monetary managers has been shaken, a gold reserve far above "normal" will be required to maintain convertibility. And today confidence in the wisdom, prudence, and good faith of the world's monetary managers has been all but destroyed. It may take years of wisdom, prudence, and good faith to restore it. Until that is done, any effort to resume a full gold standard at \$35 an ounce might precipitate a violent deflation. ❀

## How to Return to Gold

January 25, 1954

If we grant that there is a great potential danger in trying to return immediately to a full gold standard at \$35 an ounce, by what steps are we to return? And how are we to determine the dollar-gold ratio—which would decide the new "price of gold"—at which the return should be made? It is a sound general principle that unless there are the strongest reasons for change, the

dollar-gold ratio, once fixed, ought not to be tampered with. This rule certainly applied to the pre-1933 rate of \$20.67 an ounce, because that was a real rate, at which anybody was entitled to demand gold, and got it. But the \$35 rate, fixed by Roosevelt-Morgenthau whim in 1934, is not a rate at which real convertibility has existed. It is only foreign central banks, not American citizens, that are permitted to buy gold from our Federal Reserve Banks at \$35 an ounce, and even they are allowed to do this only under certain conditions. For example, they are not supposed to buy from us at \$35 an ounce in order to resell it at a profit in the open market. The present \$35-an-ounce gold standard is a window-dressing standard, a mere gold-plated standard, a sham gold standard. We have been able to maintain it only because most other nations in the last twenty years have been inflating even more than we have. There is no reason for treating the \$35 figure as sacrosanct.

The new dollar-gold ratio that we should aim at is one at which gold convertibility can be permanently maintained, and that will not be in itself either inflationary or deflationary—that will neither, in other words, bring about a rise or a fall in prices.

There are some economists who contend on unconvincing evidence that \$35 an ounce is that rate. Others profess to have some mathematical formula for arriving at such a rate, and on this basis confidently advocate \$70 an ounce or some other figure. Their diverse results in themselves invite suspicion. Values and prices are not set by mathematical calculations, but by supply and demand operating through free markets.

And because of the enormous inflation in the twenty years since we departed from a real gold standard, and the enormous shock to confidence that inflations, devaluations, and repudiations have produced, we must test the state of confidence in a temporary free market for gold—a market that will also give us a guide to a new dollar-gold ratio that we can hold.

This time schedule of gold resumption is set forward chiefly for purposes of illustration:

1—The Administration will immediately announce its intention to return to a full gold standard by a series of steps dated in advance. The Federal Reserve Banks and the Treasury will temporarily suspend all sales or purchases of gold, merely holding on to what they have. Simultaneously with this step, a free market in gold will be permitted.

2—After watching this market, and meanwhile preventing any further inflation, the government, some time before June 30, 1955, will announce the dollar-gold ratio at which convertibility will take place.

3—On and after July 1, 1955, foreign central banks will be permitted to convert dollar holdings into gold bullion, and vice versa, at the new ratio. The free market will continue to be permitted.

4—On Jan. 1, 1956, the country will return to a full gold-bullion standard. Conversion of dollars into gold bars, or vice versa, will be open to all holders without discrimination.

5—On Jan. 1, 1957, the country will return to a full gold-coin standard, by minting gold coins and permitting free conversion.

A full gold-coin standard is desirable because a gold-bullion standard is merely a rich man's standard. A relatively poor man should be just as able to protect himself against inflation, to the extent of his dollar holdings, as a rich man. The reason for returning to a full gold-coin standard in several stages is to prevent too sudden a drain on gold reserves before confidence has been re-established. A program like the foregoing would provide a faster schedule. ❁

## Balance It Now

February 1, 1954

There is cause for gratification in more than one feature of President Eisenhower's budget for the fiscal year ending June 30, 1955. Here at last is real progress toward a reduction in spending.

Estimated expenditure for the fiscal year 1955 totals \$65,600,000,000. This is \$5,300,000,000, less than the estimate for the current fiscal year, \$12,300,000,000 less than Truman had recommended for this fiscal year, and \$8,400,000,000 less than was spent in the Truman-Eisenhower fiscal year 1953.

But if we go a little farther back the comparisons are less favorable. The proposed expenditure is just about the same as that in the fiscal year 1952. It is actually \$21,600,000,000 higher than in the fiscal year 1951. And in both of those fiscal years Truman was President and the Korean war was going full tilt. Considerable further reductions are possible in expenditures in the fiscal year 1955.

Mr. Eisenhower estimates a deficit in 1955 of \$2,900,000,000. This is lower than the \$3,300,000,000 deficit expected in the current fiscal year or the actual deficit of \$9,400,000,000 for fiscal 1953. But it is still a deficit. It will be the 22nd annual deficit in the last 25 years. And there is no excuse for it, above all at a time when our national income is running at the highest levels on record.

President Eisenhower has taken over one bad habit from his Democratic predecessors. He points out that because of the payment of social-security payroll taxes, not offset by equal benefit payments, there will be a balance in the "cash" budget in the fiscal year 1955. But this "cash" balance has significance only because it does not cause immediate inflation. It is not a substitute for a balance in the regular budget. The workers are told that they are paying employment taxes to build up a reserve for their own social security. When the government spends these taxes for other purposes as they come in, and slips farther backward in its debtor position, the reserve fund becomes fictitious.

The government could cut spending even further and wipe out this prospective deficit of \$2,900,000,000. It might even be able to balance the budget after allowing the scheduled corporate-tax and excise-tax reductions to go through.

Where could the reductions in spending be made? No cuts need be made in the amounts proposed for our national defense. But in the \$44,900,000,000 allotted to the whole "national security" program, there is an amount of \$4,275,000,000 for arms aid to other countries. This is the highest amount ever proposed for this program. The argument for this expenditure is that the recipient countries cannot afford to pay for their own defense. I have pointed out in previous articles that for most of the beneficiary countries the case for relieving their own taxpayers from their own defense burden and putting it on the American taxpayer has never been proved, or even made very plausible.

In addition, we are planning to give away to other countries in economic and technical aid \$1,125,000,000 more in 1955. The case for this will simply not stand realistic economic or political analysis. The whole prospective deficit of \$2,900,000,000 could be saved out of the \$5,400,000,000 foreign giveaway program alone.

Moreover, a period of great inflation, and one in which a further deficit is in prospect, is surely not the time to pile on additional spending for social security, housing, education, and health programs. Whatever the merits of such expanded programs may be, they should at least be postponed until they can be carried out within a balanced budget. President Eisenhower has himself stated that the test of expenditures should be "necessity rather than mere desirability." And as he put it so well: "The objective will be to return to the people, to spend for themselves and in their own way, the largest possible share of the money that the government has been spending for them." This objective should be followed now. This budget, already within



5 percent of balance, can be safely balanced by a little more pruning. ❁

## Price Supports Stifle Trade

February 8, 1954

The report of the Randall Commission on Foreign Economic Policy runs to more than 100 single-spaced typewritten pages. It makes scores of detailed recommendations—on the so-called dollar problem, foreign aid, foreign investment, agricultural and raw-material policy, tariff and trade policy, East-West trade policy, merchant-marine policy, tourism, and currency convertibility. Overall judgment is difficult within any short space. I find much of its discussion of currency convertibility, foreign aid, and foreign investment, for example, disappointing; but the report makes so many contributions to clarity and common sense that it is more profitable to begin with these.

Particularly good are the sections on agricultural and raw-material policy and on tariff and trade policy. On the farm program, the report courageously points out that “inflexible *price-support* programs which hold domestic prices above world prices become price-fixing programs and result in accumulations of surpluses that would otherwise have moved into consumption here or abroad. To maintain such price-fixing programs it may become necessary for the U.S. to apply trade restrictions of various kinds, including import quotas, to keep down foreign importations. To move high-priced surpluses into export markets it may seem necessary to use export subsidies or dumping procedures that, if practiced with respect to imports into this country, would involve the application of our antidumping and countervailing-duty laws. Price fixing, particularly with reference to commodities moving in international trade, is inherently incompatible with a pattern of private trade, free enterprise, and nondiscriminatory commerce among nations.”

The commission is highly critical of the existing International Wheat Agreement. It “does not believe that extensive resort to commodity agreements will solve the problem of price instability. . . . Such agreements introduce rigidities and restraints that impair the elasticity of economic adjustment and the freedom of individual initiative, which are fundamental to economic progress.” It also “finds the same objections to the proposals for unilateral buffer stock action by the U.S. to stabilize world prices of raw materials and foodstuffs.” The commission’s recommendations with regard to tariffs and trade deserve praise for more than one reason.

They acknowledge the need of “moving toward greater freedom of trade.” But they recognize that complete “free trade is not possible under the conditions facing the United States today.” They acknowledge that “the United States employs impediments to trade, primarily through tariffs and in only limited fields through quotas.” But: “Other countries also employ these devices. Beyond this, they employ the quota procedure far beyond our use . . . and also employ exchange controls and many other devices not used here. . . . We fully recognize the dangers of using averages; yet it seems clear by any test that can be devised that the United States is no longer among the higher tariff countries of the world. Taken by and large, our trade restrictions are certainly no more of a cause of payment imbalances than the rigidities maintained by other nations.” It is high time this reply was made by an official body to the countries that have been self-righteously demanding a one-sided reduction of trade barriers by the U.S.

Finally, the report is to be praised because it recommends an immediate but gradual reduction of our trade barriers. The extension of the Trade Agreements Act for at least three years; authority to the President to reduce present tariff rates, in trade-agreement negotiations, by 5 percent a year during the next three years; to reduce tariff rates by not more than one half of rates in effect Jan. 1, 1945, on products being imported in negligible amounts; to reduce, over a three-year period, to 50 percent ad valorem, or its equivalent, any rate in excess of that ceiling—these are moderate objectives on which agreement should be possible if we are to arrive at any sensible solution of the foreign-trade problem at all. ❁

## Ike's Semi New Deal

February 15, 1954

When President Eisenhower at his press conference on Jan. 27 was invited to comment on statements by some observers that his program was an “extension of the New Deal,” he is said to have told the reporter “in a tone of steely indignation” to compare Mr. Truman’s budget with his own.

But such a comparison is not in itself convincing. It is true that Mr. Eisenhower’s proposed Federal expenditure for the fiscal year 1955 is \$12.3 billions less than Mr. Truman recommended for this fiscal year; but it is not less than Mr. Truman actually spent in 1952, his last full fiscal year in office; and it is actually \$21.6 billions higher than Mr. Truman spent in the fiscal year 1951. During both those fiscal years, incidentally, the Korean war was being fought.



Nor was Mr. Eisenhower's second reply to the reporter's question much more helpful. "When it comes down to dealing with the relationships between the human in this country and his government," he said, "the people in this Administration believe in being what I think we would normally call liberal, and when we deal with the economic affairs of this country, we believe in being conservative." I must confess that I do not know quite what this means, because I have always assumed that all economic affairs were human affairs, and that all economic welfare meant human welfare.

Yet Mr. Eisenhower could have convincingly drawn many sharp contrasts between his own policies and the policies of the New Deal. He removed the New Deal wage and price controls—an achievement of the first importance. In the early part of his Administration, he put at least a temporary halt to inflation. In the economic report that he transmitted to Congress on Jan. 28, he put a stress that the New Deal would never have done on fostering economic growth through economic freedom, in creating "an environment in which individual enterprise can work constructively to serve the ends of economic progress."

If we wish another contrast, we can compare his statement: "It is well to recall the accumulated experience of generations which has taught us that no government can of itself create real and lasting prosperity," with Mr. Truman's first "basic economic principle," announced in his own final economic report in January 1953, that: "Full employment must be a constant objective of policy."

Some of us could wish, however, that these contrasts were more frequent and consistent. When it comes to concrete policies, the contrasts sometimes seem to be outnumbered by the similarities. We may point especially to the recommendations for additional spending for social security, housing, education, and health programs, as well as to the ambiguous attitude toward public spending. There is the constant intimation, throughout the economic report, that at the first real sign of a downturn the government would throw itself into pump-priming projects. Take this, for example: "The government will not hesitate to make greater use of monetary, debt management, and credit policy, including liberalized use of Federal insurance of private obligations, or to modify the tax structure, or to reduce taxes, or to expand on a large scale the construction of useful public works, or to take any other steps that may be necessary." And at another point the President declares that his antirecession policies will not be allowed to "interfere *any more than is necessary*

[my italics] with the fiscal objective of bringing down the scale of Federal expenditures, reducing taxes, and arriving at a budgetary balance."

This seems to take over from the New and Fair Deals the essence of the Keynesian ideology—the belief in "compensatory spending," the belief that any decline from a peak of inflationary prosperity can and should be offset and rectified by an increase in deficit spending—in brief, by further inflation. My belief is that this ideology is unsound and dangerous; but it is still not clear just to what extent Mr. Eisenhower holds it. As long as its ambiguities and vacillations continue, we will not be unjust in calling its present policies the Semi New Deal. ☸

## Coffee, Butter, and Politics

February 22, 1954

Others—*The Wall Street Journal* and economist Sumner Slichter, for example—have already pointed to the striking contrast between the attitude of some of our congressmen toward coffee prices on the one hand and butter prices on the other. But the contrast will bear further emphasis.

Some of our congressmen have been furiously indignant about the high price of coffee. As the gentleman from Iowa or New York orders another Martini at 75 cents a throw, he tells us what an outrage it is that his coffee at home now averages him about 3 cents a cup. The price of butter is also high; but in reply to this his only comment is that it isn't high enough. Could it be that this strange contrast has anything to do with the fact that coffee growers don't vote in his district, while dairy farmers do?

The chief reason for the recent rise in coffee prices has been a shortage in the supply. For the past seven years the world has been drinking more coffee than it has been producing. This has worked down the carry-over. And in the last crop year drought and frost in Brazil killed millions of coffee trees. As people in the trade have pointed out, no Congressional investigation will increase the world's supply of coffee by a single pound.

But the price of coffee, we are told by some of our Washington solons, has been pushed up by "speculation" and "manipulation." In a free market economy, of course, speculation enters into the price of practically everything. And it usually confers a benefit on society by doing so. If speculators bid up the price of coffee, for

example, because they correctly anticipate or recognize the existence of a shortage, they help to prevent the shortage from becoming as bad as it otherwise might. For the high price not only discourages wasteful consumption, but encourages increased production.

The chief reason why coffee is subject to comparatively violent fluctuations in price is not speculation (which actually tends to mitigate fluctuations) but a fact of nature. It takes about five years for a new coffee tree to start bearing in commercial amounts. After it does start bearing it usually continues to do so for ten to twenty years. So no matter what happens to the price, it normally takes a few years for supply to adjust itself. To force the price down artificially, however, would only further prolong the period of adjustment.

It may be that the Senatorial sleuths will find some real “manipulation” of the price of coffee. But suppose they do? Will it even begin to compare with the open manipulation by our own government of the price of butter? Not to speak of cheese, dried milk, wheat, cotton? Our government is running a gigantic butter cartel which is at this moment holding off the market 264 million pounds of butter in order to force American working families to pay more for it. From this comparison we may judge the hypocrisy of the Congressional outcries against the high price of coffee.

I do not mean to imply that Brazil has always been guiltless of any attempt to manipulate coffee prices. On the contrary, in its efforts to force up coffee prices, the Brazilian Government for years burned coffee or dumped it into the sea. During 1931 to 1934, for example, the government burned 27 million bags of coffee as locomotive fuel.

This was the same kind of beggar-my-neighbor policy that our own government is trying to follow today with our own farm exports. Instead of hypocritically denouncing the immorality of such policies when pursued by others, our congressmen and our own farmers might more profitably study their consequences. Insofar as Brazil's coffee-burning had any effect in holding up prices, it merely encouraged Colombia and other Latin American countries to increase their own plantings. The result was that Brazil, which in the 1920s supplied two thirds of the outside world's coffee, supplies less than half today.

So Brazil's destruction of coffee in the end hurt the very producers it was intended to benefit. This is the real lesson for our farm price support pressure groups to ponder, as tons of butter turn rancid in storage while oleomargarine consumption grows. ☼

## The Dollar-Gold Ratio

March 1, 1954

One of the most serious hurdles in the path of a return to the gold standard is the wide disagreement, even among those who favor such a return, regarding the exact dollar-gold conversion rate at which that return should be made.

The gold-standard supporters are divided into three main groups: (1) those who think we could safely return to a full gold standard at \$35 an ounce; (2) those who urge return to a full gold standard at some specific higher price for gold (e.g., \$70 an ounce) which they claim they already know to be the “correct” one; and (3) those who recommend that we permit a temporary free market in gold for the guidance it will provide in fixing a final dollar-gold conversion rate.

I have already discussed (*Newsweek*, Jan. 18) the main arguments of those who urge a return to gold at \$35 an ounce, and what I consider to be some of the shortcomings of those arguments. Those who are urging that we set the price of gold at a higher figure, and who claim to know already what that figure should be, commonly base their conclusion on some comparison of price levels. For example, since 1932, the last full year in which we were on a real gold basis (at \$20.67 an ounce), wholesale prices have increased 162 percent. On the argument that only a corresponding increase in the price of gold could prevent a fall in prices if we went back to a full gold standard, the new price of gold would have to be about \$54. Again, the price of gold was set at \$35 an ounce on Jan. 31, 1934. For the next seven years wholesale prices averaged only 47 percent of their present level. If we assume that \$35 was the “right” price of gold in those seven years—1934–40—then the price of gold necessary to maintain the present wholesale price level might have to be about \$75.

The dubious nature of the assumptions behind such calculations is clear. But the rate at which we return to a full gold standard is not a matter of indifference. Charles Rist, one of the world's leading monetary economists, argued in a powerful article in *Foreign Affairs* in April 1934 that one of the major causes of the world crisis of 1929–33 was the attempt of leading countries, including the United States, to maintain or return to gold convertibility at their prewar rate for gold after having enormously multiplied their paper currency circulation.

The case of Great Britain is clear. It had gone off gold in the first world war. The pound had dropped from a gold parity of \$4.86 to a low of \$3.18 in February 1920, and had returned in late 1924 to approximately 10

percent below the gold parity. But wholesale prices in Britain in 1924 were still 70 percent above their prewar level. The British Government decided to resume the gold standard at the old par in 1925. The result was a steady fall in wholesale prices over the next seven years from an index number of 171.1 (1913 equals 100) in January 1925 to 99.2 in September 1931, the month in which England abandoned the gold standard. As the British all during this period were unwilling to make corresponding cuts in retail prices and wage rates, the result was falling exports, stagnation, and unemployment. And it was the gold standard itself, not the false rate (or the internal inflexibility of wages), that got the popular blame.

The British repeated this pattern in essence in the summer of 1947, when they tried to make the pound convertible into the dollar at the wholly unrealistic rate of \$4.03. When that experiment broke down within a few weeks, the British once more blamed convertibility itself, and not the false rate, for the breakdown.

It is of the highest importance not only to our own economic future, but to the future of the world, that we do not repeat the British errors by trying to return to gold convertibility at an overvaluation of the paper dollar (which would mean an undervaluation of gold). A temporary free market in gold would give us more guidance regarding what the new conversion rate should be than either an adamant insistence on \$35 an ounce or some dubious calculation based on a pure theory. ❁

## Still More Inflation?

March 8, 1954

There are ominous signs that President Eisenhower's budget is bursting apart at the seams, and that a demagogic scramble for votes will launch us into still more huge deficits and inflation.

Mr. Eisenhower's 1955 budget was not sound in the first place. He planned a deficit of \$2.9 billion, which would be the 22nd annual deficit in the last 25 years. Whereupon both Republicans and Democrats began to advocate still further tax cuts, especially in excises. And they even began to talk of his \$65.6 billion budget as "pinchpenny."

Then Mr. Eisenhower further weakened his own position by his remarks at a press conference on Feb. 17. He said that if employment did not pick up in March we would have a very definite warning that would call for a number of measures, and tax reduction might be one of the first to be considered. He added that the

government wouldn't hesitate one second to do everything to stop any real recession.

These remarks were disturbing for more than one reason. They attached a peculiar importance to the month of March that experience does not warrant. They placed an undue importance on unemployment statistics that are themselves largely a matter of guesswork. (The Commerce Department's result was revised as much as 30 percent when it changed its sampling.) Unemployment statistics are also among the most lag-gard of business indexes.

But most disturbing of all was the implication that the President had accepted the heart of the Keynesian and New Deal philosophies, which throw all their emphasis on consumer spending and assume that the one sure way to avert depression and keep a boom whipped up forever is to unbalance the budget and resort to pump priming and more inflation.

Two days after the President's press conference, Democratic Senator George, hitherto regarded as a rock of financial conservatism, started to anticipate and outbid Mr. Eisenhower by calling for an immediate increase of \$200 in personal exemptions for all income-tax payers. And two days after that Democratic Senator Douglas threw whatever economic prestige he has left into endorsing the proposal. The first effect of this scheme would be, of course, to increase the deficit enormously. It has been calculated that an increase in the personal-income-tax exemptions from \$600 to \$800 would mean a loss of \$4.6 billion in this year's revenue. So even without any further increase in expenditures or additional tax reductions, this means that the prospective deficit, instead of being \$2.9 billion, would be \$7.5 billion. Unabashed by this, Senator George even proposed a further increase of the exemptions to \$1,000 next year, which would mean a loss in revenues of \$9.2 billion annually. And now it is generally assumed that the Republicans will be "forced" into raising the exemptions at least \$100 annually. This would mean a revenue loss of \$2.3 billion annually—or a deficit, other things being equal, of \$5.2 billion. Such a procedure would be utterly irresponsible. The alleged economic reasoning behind it is a mere rationalization of political expediency. Naturally it appeals to politicians who want to make the popular gesture of cutting taxes without the unpopular action of cutting expenditures. This is naked inflationism, proposed by men who still pretend to be "fighting depression" though our national income in 1953 was the highest in our history.

President Eisenhower can successfully combat this demagoguery, irresponsibility, and inflation only if he takes a solid stand on principle. He cannot hold the



line if he merely tries to stick by his January budget. He cannot convincingly argue that a deficit of \$2.9 billion is all right but a deficit of \$5.2 billion is all wrong. He can succeed only if he stands on the firm economic and political principle that the budget must be fully balanced, and now. And then he can demand of any group in Congress that wants the fun of cutting taxes that it first of all cut expenditures by the same amount. The only alternative to this course is economic and political demoralization. ❀

## Lesson of the Greenbacks

March 15, 1954

In this column of March 1, I pointed out what happened in Britain when it tried to go back to the gold standard at the old parity in 1925. But there are many who believe that our own resumption of gold payments on Jan. 1, 1879, at the prewar parity, after the paper-money inflation of the Civil War, was an unalloyed success. The fears of a gold drain, they argue, proved quite unfounded; on the very first day *receipts* of gold actually exceeded payments by \$268,000. And they attribute the subsequent American recovery of 1879 largely or wholly to gold resumption.

A closer examination of the whole inflationary and deflationary period from 1862 to 1879, however, tells a different story. As soon as the government started issuing irredeemable "greenbacks" in 1862, gold went to a premium on the open market and commodity prices started to soar. In 1864 the greenbacks fell as low as 35 cents on the dollar in terms of gold. From 1860 to 1865 inclusive, though the average of European prices rose only 4 to 6 percent, average prices in the United States advanced no less than 116 percent.

But immediately after the end of the war American prices started downward. At first this was politically popular, because wages had not yet advanced as much as the cost of living. But after 1866 wages had more than caught up with prices. The continued fall in prices soon began to cause bankruptcies and unemployment. Finally came the panic of 1873 which, in the measured judgment of some economists, "left the country's financial and commercial structure almost a ruin." The causes of the panic were complex. But one of them was certainly the continued fall of commodity prices that accompanied the rise of the greenbacks toward parity. By 1873 the greenbacks were only about 15 percent below parity, and wholesale prices were down to about 30 percent above prewar levels.

The result of the panic of 1873 was greatly to increase inflationist sentiment. The Resumption Act was passed on Jan. 7, 1875, but by a repudiated lame-duck Republican Congress that had nothing more to lose. Even more ironic, it was passed, the economist J. Laurence Laughlin tells us, "only under the delusion that it was an inflation measure," because "on its face it looked like a bill to expand the national bank circulation." Many commentators today think it was foolish and needless for the Resumption Act to put off the actual day of resumption to Jan. 1, 1879 four years after passage of the act. They forget, however, that time, skill, and determination were required to accumulate a gold reserve so impressive that gold would not be demanded when the day of resumption came. And they forget, too, that returning to gold at the original parity involved a still further decline (of about 30 percent) in American commodity prices to bring them into line with world gold prices. This decline took place between 1875 and 1879, and the whole period was one of liquidation. In 1878, for example, the record of insolvencies far exceeded even that of the panic year 1873. Many commentators today attribute the recovery that came in the second half of 1879 to the return to gold redemption. The facts do not support them. "With hardly an exception," writes the economic historian, Alexander D. Noyes, "the country's staple industries sank, during the early months of 1879, into complete stagnation." What suddenly turned the tide was an unparalleled coincidence: Europe suffered the worst crop disaster in many years, whereas the American wheat crop reached a new high record. This meant high prices and crop exports unparalleled up to that time.

All this is not to argue that after the greenback inflation of the Civil War this country should have returned to gold at a lower parity for the dollar. It is simply to point out that we had to pay a heavy price for the course we actually took, even though our economy was far more flexible then than now, particularly as regards wage rates. We must take care that when we return to gold this time we do so at a rate that involves neither inflation nor serious deflation. ❀

## Wages, Unions, and Jobs

March 22, 1954

One of the great historic myths of our time is that labor was ruthlessly "exploited," and wage increases practically unknown, until New Deal laws and a strong union movement forced employers to be "fair."



Economists have long pointed out what is wrong with such a belief on theoretical grounds. In 1933 Rufus S. Tucker put together indexes which tended to show that since 1815 “real” wages in the United States (i.e., the purchasing power of money wages) had been rising at an average annual rate of 1 percent. But until rather recent times the available statistics have been scattered and uncertain. A few weeks ago Leo Wolman, professor of economics at Columbia University and a former member of the National Labor Board, presented before the American Statistical Association a study of wages since 1914 which brought out some remarkable results.

Dr. Wolman’s paper dealt with hourly wages in five industrial classifications—manufacturing, Class 1 railroads, building, anthracite and bituminous coal mining. He found that in the period from 1914 to 1953 both money and real hourly wages multiplied many times. Anthracite money wages increased more than nine times, the real wage rose 3.5 times. In manufacturing, money wages rose 7.5 times; real wages 2.8 times. In building, money wages increased less than sixfold, and real wages little more than doubled.

Even more striking is a comparison of money and real manufacturing wage rises in different periods:

Period	Percent increase in	
	Money Wages	Real Wages
1914–1920	155	25
1920–1929	.....	19
1929–1940	16	42
1940–1953	156	34

These comparisons lead to several striking conclusions. In the whole period from 1914 to 1953, “real” wages (i.e., wages in terms of what they will buy, after allowance is made for changes in the cost of living) “showed marked improvement whether money wages were increasing much or little, or whether business conditions were good or bad, favorable or unfavorable to price increases, or whether unions were strong or weak.”

Another remarkable result emerges when we compare two separated periods of about the same length. In the fifteen-year period from 1914 to 1929, real hourly wages increased 48.5 percent. In the thirteen-year period from 1940 to 1953, real hourly wages increased 34 to 39 percent. In other words, there was a greater annual increase in real hourly wages in the earlier period, when union membership rose from 2.6 to only 3.6 million workers, than in the later period, during

which union membership rose from 8.9 to 16.5 million workers.

There was, it is true, an extraordinary increase in real hourly wages, in the period from 1929 to 1940, of 42 percent, which would doubtless not have been as great except for the policies followed by the government and the unions. But it is significant that that period also showed the highest unemployment on record. And in the anthracite industry, which showed the greatest increase in wage rates of any of the five groups over the whole period, employment dropped from 170,000 in 1914 to 59,500 in 1952. From this preliminary statistical study Dr. Wolman’s own conclusions are cautious. But the figures tend to confirm certain conclusions that many economists have long held through previous evidence and analysis:

1—There is little reason to suppose that over the long run, and considering the whole body of labor, unions have brought about much if any of the increase in real wages that has historically taken place.

2—Wherever a union in a single industry has been able to force up wages beyond the level that competition would have brought about, the rise has been mainly at the expense of the real wages of other workers, by raising their living costs.

3—Wherever unions have for a time succeeded in raising the general average of wages above their “equilibrium” point, they have done so only by creating unemployment. ☼

## For Whom the Tax Bell Tolls

March 29, 1954

Elsewhere in this issue Raymond Moley deals with the political implications of the Democrats’ attack on the Administration tax program. I shall confine myself here to their proposals for raising personal-income-tax exemptions.

President Eisenhower, in his courageous and statesmanlike TV talk, had no difficulty in exposing the transparently demagogic character of these proposals. Even a \$100 increase in the personal-income-tax exemptions would mean 4 million fewer taxable returns than the present total of about 47 million, and a loss of \$2.4 billion in annual revenues. A \$200 increase in the exemption, as proposed by Senator George, would mean a loss of 7.6 million such returns, and a loss of \$4.5 billion in annual revenues.

Let us pass over for a moment what this would mean in terms of deficits and inflation, and concentrate on its demagogic implications. Even the present

personal-income tax has become a class tax, particularly so far as rate progression is concerned. The Democratic proposals would make it more of a class tax than ever. To relieve 4 to 8 million more people of the necessity of paying an income tax is to relieve that many voters of any concern about governmental extravagance and to foster in them the illusion that “the other fellow” is paying the bill.

If taxes are to be reduced any further at this time, the real place where the reduction ought to begin is precisely where no one in public life has had the courage to suggest—from the top. Personal-income-tax rates for this calendar year run up to 91 percent. Yet if the government were willing to lose as much as \$2.5 billion revenues a year in some other way than by increasing exemptions by \$100, it could eliminate all tax progression beyond the rate of 34 percent (which now applies to net income brackets between \$8,000 and \$10,000) and lose no more than that.

The present steeply progressive income-tax rates are a reflection chiefly of envy and vindictiveness. They represent a desire to punish success rather than to maximize government revenue. The workers of this country are being cruelly deceived when they are led to think that “the rich” are paying most of the taxes because of these confiscatory rates. Of the \$31 billion that the personal-income tax yields, only about \$1 billion comes from the rates above 50 percent. Only \$3 billion, or one tenth, comes from the rates above 30 percent. In fact, *if there were no tax progression at all*, and the income tax never rose higher than the 20 percent rate that now applies only to the net-income tax brackets below \$2,000, the total maximum revenue loss would amount to less than \$5.4 billion.

It is a safe presumption, indeed, that the upper-bracket income-tax rates are already far above the rates of maximum return. If the rates were cut to a maximum of 50 percent, the income tax would within a few years (if not, indeed, even in the first year) yield *more* revenue from net incomes above \$18,000, not less.

But the worst harm done by these rates is not that they reduce government revenue, serious as this is. The worst harm is that they discourage the most productive people from producing and earning what they would otherwise produce and earn. They deprive the nation of this production and of the new enterprises that would otherwise be launched. These confiscatory rates siphon off the cream of the very funds that would otherwise go into new investment—the new investment that not only creates new jobs but in the past has created the marvelous machines, factories, and technological advances that have multiplied the productivity and wages of the

American worker beyond those of the workers of any other country or any other period in history.

It is hard for most of us to put aside our envy when the question is raised of lowering the tax rate on some income bracket higher than our own. But it is all of us who are losing income by these confiscatory rates. And therefore never send to know for whom the high-tax bell tolls; it tolls for thee. ⚙

## Soak Rich and Hit Poor

April 5, 1954

The present drive to raise the income-tax exemptions and relieve millions of voters from the obligation to pay any income tax whatever is merely the latest illustration of how easily the progressive income tax can be turned into a demagogic weapon and a political football.

In the light of the ideological history of the tax this development should not be too surprising. In the *Communist Manifesto* of 1848, “a heavy progressive or graduated income tax” is listed as the second point of a ten-point program that Marx and Engels demanded in order to make “despotic inroads on the rights of property” and as “unavoidable as a means of entirely revolutionizing the mode of production.” In the course of time “bourgeois” economists came to recommend such a tax in increasing numbers. But the excesses to which it has been carried (and which would have delighted Marx) have recently begun to produce a revulsion of feeling and thinking on the part of some economists who have had the courage to speak out.

A few years ago, for example, Harley L. Lutz of Princeton, arguing for a proportional income tax, contended that there was no logical stopping place to the progressive principle, based on the current specious form of the “ability to pay” theory, short of “complete equalization of incomes by confiscation of all incomes in excess of the lowest amount received by anyone.” And more recently two University of Chicago lawyers, Walter J. Blum and Harry Kalven, Jr. (in *The Uneasy Case for Progressive Taxation*, University of Chicago Press), and the economist F.A. Hayek, have subjected the progressive-income-tax principle to searching criticism.

Let’s try to set down some of the main objections:

1—It is a dubious moral principle, an abuse of democracy, and an invasion of minority rights, for a majority to impose on a minority a higher tax rate than it accepts for itself.

2—The legal requirement of time-and-a-half wage rates for overtime is based on the assumption that

progressive incentives are necessary to get people to work longer and that progressive rewards are justified as the workload increases. But the present income tax is based on precisely the opposite principle of decreasing rewards for increasing work. Take, for hypothetical illustration, a top-level surgeon who averages \$500 an operation and might take on 240 paid operations a year. This would bring his income before taxes to \$120,000. For his first operation in January he would get and keep \$500. Going into February he would only be earning net (after income tax) \$310 per operation. Along about June he would be getting (net) only \$140 an operation. And when he got into November he would be turning over \$445 of every \$500 fee to the government and getting only \$55 for himself. Under the present income tax the same principle applies, if less dramatically, to the incomes of all of us. The more hours we work, the less we get paid per hour.

3—Under this system people are penalized in direct proportion to their productiveness. Inevitably this tends to kill incentives to production and reduces the total national income and living standards.

4—The progressive income tax skims off precisely the funds most likely to go into new investment—into building the new tools and equipment that increase the productivity of the country and lift the living standards of the workers. It slows down the rate of economic progress.

5—And lastly, these confiscatory rates do not even raise revenue. They destroy the sources of revenue. The great illusion of the present age is that through these confiscatory rates we have been able to throw the burden of huge government spending on to the very rich. But analysis shows that only 8 percent of the personal income tax is paid by those making more than \$100,000 a year, and only 16 percent is paid by those making more than \$50,000 a year. Looking at the matter from the other end, 74 percent of the income tax is paid by people earning less than \$25,000 a year, and 59 percent of it is paid by people earning less than \$10,000 a year. ❀

## Trade, Not Giveaway

April 12, 1954

Much in the President's recommendations on foreign economic policy is thoroughly sound and should receive the full support of Congress.

This applies to his plea for a three-year extension of the trade-agreements act which would authorize him to reduce present tariff rates, in trade-agreement

negotiations, by 5 percent a year during the next three years; to reduce tariff rates by not more than one half of rates in effect Jan. 1, 1945, on products not being imported or being imported in negligible amounts; and to reduce, over a three-year period, to 50 percent ad valorem, or its equivalent, any rate in excess of that ceiling.

These are moderate objectives. They are the recommendations of the Randall commission. One of the assurances to which European exporters are surely entitled is that if they plan to sell in the American market, and can successfully do so, we will not suddenly start to *increase* the barriers against them. Legislation permitting further tariff reductions will help to give this assurance.

For the same reason Congress should accept Mr. Eisenhower's proposal exempting from provisions of the so-called Buy America acts bidders from nations that treat our bidders on an equal basis with their own.

Another welcome statement in Mr. Eisenhower's message is that "economic aid cannot be continued indefinitely. . . . [Such aid] on a grant basis should be terminated as soon as possible . . . [and] to the maximum extent appropriate should be in the form of loans." It is unfortunate that the President did not see fit to apply this principle to military aid also. The contention of European governments that they cannot afford to pay for their own armament programs will not stand serious analysis.

Unfortunately, other parts of the President's foreign economic program are not as sound as his proposals for lowering tariff barriers and reducing the dimensions and cost of the giveaway program. He approves, for example, the Randall commission's recommendations "that the United States withhold reductions in tariffs on products made by workers receiving wages which are substandard in the exporting country." This proposal is wholly objectionable. The question of what wages are "substandard" by another country's standards is a matter of arbitrary opinion. We could not determine the facts about wages in a foreign country unless we insisted that our own snoopers be allowed to enter it and investigate. The proposal would breed backdoor efforts to keep protectionism under the pretense of deep concern for the welfare of the workers whose products we discriminated against.

The President also asks for excessive discriminations in favor of foreign investment. Such discriminations would have the effect of increasing the tax burdens on domestic investment. It is one thing to argue that there should be no discrimination *against* foreign trade and investment. It is quite another thing to argue that



investment in foreign countries is *better* for us than investment in our own. This is untrue. And rather than expand, at the taxpayers' expense, government guarantees of bad private foreign loans, no further guarantees should be offered.

The Export-Import Bank should not finance foreign-development projects. It is more than doubtful, in fact, that it should continue to exist. And there is certainly no reason why our government should grant still more loans to foreign governments to make their currencies convertible when they could achieve that end simply by ceasing to forbid convertibility.

Mr. Eisenhower declares that the foreign economic policy he presents is an interrelated whole in which each part "requires the other." But even if we pass over his failure to ask for repeal of import quotas, several of his leading recommendations are quite inconsistent with each other. Lower and simpler tariffs make for greater freedom and trade. More and bigger giveaway programs make for inflation or heavier tax burdens at home and more statism everywhere. The President should not imperil what is sound in his program by tying it to what is dubious. ❁

## Three Budgets

April 19, 1954

On April 6, Finance Minister Abbott presented the new annual budget for Canada, for the fiscal year which began on April 1, and Chancellor Butler presented the new annual budget for Britain, for the fiscal year which began on the same date. To an American what is most noteworthy about each of these budgets is the simple fact that it is balanced.

In contrast, our own Federal budget is officially expected to show a deficit for the current fiscal year, which ends on June 30, of \$3.3 billion. For the new fiscal year to begin on July 1 it carries an estimated deficit of \$2.9 billion. Both deficits are expected in actuality to be even higher.

The explanation of our own budget deficits, compared with the budget balance of our two principal friends and allies, is threefold. The first part of the explanation is that Canada and Britain both have budget systems for which responsibility can be definitely fixed, whereas the United States does not. The British Parliament, for example, approves the government's budget, including both proposed expenditures and proposed taxes, as a unified whole. And once the budget has been approved, Parliament abides by a wholesome

rule under which it cannot make any appropriation for which the government has not asked.

No such rule prevails here. The budget presented annually by the President is nothing more than a compilation of estimates and recommendations which Congress is free to accept or reject or ignore, and which it never in fact adopts as an integrated whole. Congress can appropriate more money than the President asks for. It can make tax reductions that he has not asked for. The President has no power to veto individual items in appropriation bills. So one explanation of the Canadian and British budget balance as compared with our chronic deficits is that they have a more responsible budget system.

But this is only part of the explanation. It is one of the paradoxes of the present situation that America, which has a budget deficit, is contributing defense aid to Britain, which has a balanced budget. This becomes less of a paradox when one recalls that it is partly *because* we are granting defense aid to other countries that we have a budget deficit, and it is partly *because* Britain gets defense aid from us that its budget is balanced.

A third point is this. American military expenditures are not only much higher than Canadian or British military expenditures in absolute terms, as we might expect, but such expenditures also constitute a much higher percentage of our total budget. Canada's defense expenditures will constitute about 43 percent of its total budget; Britain's about 36 percent; and ours about 68 percent. What percentage is "right" is largely a matter of opinion, to which only iffy answers are possible. But it is a pretty safe assumption that most of our Federal expenditures today, and above all the grand total, are larger than they need to be, particularly in relation to what we get for them. This at least is the conclusion at which the Committee on Federal Tax Policy, a private group under the leadership of former Under Secretary of the Treasury Roswell Magill, has just arrived after a most careful study. Scrutinizing proposed expenditures by major items, the committee finds that a total of at least \$8 billion could be cut from Federal budget obligations for the fiscal year 1955 without even touching defense items. And only a cut of these dimensions, it thinks, will solve our fiscal problem:

"If we accept the principle that a balanced budget is a desirable end and that tax reduction is essential to the continuation of a healthy economy, the only alternative is to reduce expenditures. . . .

"The fundamental trouble with the Federal tax system is that we are trying to raise too much money with it. Any tax system for collecting revenues of the order of \$70 billion is bound to be burdensome, inequitable, and



a deterrent to investment, production, and economic progress. Such high taxes tend to defeat their own end by destroying the base on which they rest.” ❁

## High Taxes vs. Revenues

April 26, 1954

Seven years ago (in *Newsweek* of April 7, 1947) I ran an article containing a couple of tables to show, first, how much was actually left at various income levels for the income-tax payer himself out of every extra dollar he earned and, secondly, what had happened to the tax rates on and the revenues from personal incomes over \$300,000 between 1926–28 and 1942. It seems to me that it throws additional light on the nature and effects of our present income-tax structure to bring such comparisons up to date.

The new tables presented here were compiled for me by the Tax Foundation.

Here is a table showing how much a married man with two children and legal deductions amounting to 10 percent of his gross income is allowed to keep out of each additional dollar of income at various income levels:

Gross Income	Taxpayer keeps out of each additional dollar
\$ 2,000	\$1.10
4,000	.80
8,000	.78
16,000	.70
32,000	.57
64,000	.38
128,000	.25
350,000	.10

It should perhaps be pointed out that the married man in the table is assumed to have taken advantage of the split-income provisions which have provided a very marked tax relief since they have been in effect. A table showing what is left for the single man in the same income brackets out of each additional dollar would present a very different picture. The unmarried taxpayer is allowed to keep less than half of every dollar he earns over \$18,000 net.

Putting aside all questions of “fairness,” we have looked at the principal practical effect of such tax rates in previous articles. That effect is to soak up the principal sources of investment funds—the funds that would

otherwise go into improved machines and new factories to increase productivity, jobs, and wages.

But a hardly less important effect is to diminish the incentives to bring such earnings into existence in the first place. This means not merely a loss to the taxpayer who does not trouble to earn the money. It means a loss to the wealth of the whole nation and a loss even to the Treasury itself. Let me begin by reprinting the table from my 1947 article. (The dollar figures stand for millions of dollars.)

	1926–28 average	1942 average
National income	\$77,000	\$122,000
Incomes over \$300,000-		
Total amount	\$ 1,669	\$ 376
Taxes paid	\$ 281	\$ 292
Top tax rate applicable	25%	88%
Number of returns	2,276	654

Let’s recall what this meant. During the same period that the total personal incomes in the nation increased 58 percent, total incomes over \$300,000 fell 77 percent. If the aggregate of such incomes had risen no more than proportionately to the whole national income, the total would have reached \$2,637 million—seven times greater than it actually was. And if this income had been taxed at the same schedule as in 1926–28, with a top rate of only 25 percent, the yield to the Treasury would have been \$444 million, or 50 percent greater than the actual yield from the greatly reduced income total taxed at a top rate of 88 percent.

Now let’s take comparisons (again in millions of dollars) since 1947:

	1947	1950
National income	\$191,000	\$226,706
Incomes over \$300,000-		
Total amount	\$575	\$1,165
Taxes paid	\$402	\$764
Top tax rate applicable	86%	84%
Number of returns	1,074	2,132

Though total personal incomes, to point to only one comparison, *increased* 148 percent between 1926–28 and 1947, incomes over \$300,000 *fell* to about a third of their earlier total. Even if the aggregate of incomes over \$300,000 had increased merely in proportion to

the total of all incomes (though even per capita incomes increased 75 percent), it would have been more than seven times as great as it was. The most important reason for this fall was a top tax rate of 86 percent compared with a top tax rate of 25 percent. A sharp reduction in top tax rates below the present level of 91 percent would *increase* government revenues. ❁

## The Policy Is Inflation

July 5, 1954

The Eisenhower Administration's monetary policy has now become clear. It is the same as that of the Democratic New Deal and Fair Deal administrations—inflation. Conclusive evidence was supplied on June 21 when the Federal Reserve Board cut by \$1.5 billion the reserve requirements of member banks. This will permit those banks to increase their loans by a total estimated from \$7.5 to \$9 billion.

There is little doubt regarding the primary reason why this was done. The federal government is still running a deficit. It is expected to borrow something like \$10 billion between now and December. Their increased borrowing power will enable the nation's banks to buy the government's new securities and to pay for them, in effect, by creating new paper money.

The lowered reserve requirements will also permit the banks to create and lend additional money to business. They will enable the government itself to borrow cheaper. By allowing business to borrow at very low rates it is presumed that they will encourage business and employment and incidentally make the November elections safer for the Republicans.

This latest move of the Federal Reserve Board does not stand in isolation. Just about a year ago, on June 24, the Eisenhower Administration, which until a few months before had been making serious efforts to halt inflation, took the drastic inflationary step of reducing the reserve requirements of member banks to release at that time about \$1,156 million of reserves. This was done to give the nation's banks about another \$6 billion in lending power—in anticipation of Treasury needs of some \$6 billion of “new money” in the following three months. Since then, most of the Administration's moves have been in the inflationary direction.

How necessary was this June's new shot of inflation? Was it needed to pull the country out of a serious slump? On the contrary, it came on the same day that *The New York Times's* combined average of 50 stocks reached the highest level in 24 years. It came when the latest cost-of-living index reached a level of 115 percent

of the 1947–49 average, higher than a year before and within 1 percent of the highest monthly average ever reached by the cost of living. It came a week or two after the Treasury sold 91-day bills at an average yield of 0.616 percent, the lowest in seven years.

This low borrowing rate was not, of course, the result of any higher standing on the part of our Federal government's credit. That government is still running a deficit, bumping against its legal debt ceiling of \$275 billion and trying to get Congress to lift the ceiling still farther. The low money rate is the result chiefly of an abundance of paper money and manufactured credit. As compared with \$64.7 billion in 1939 (total bank deposits and currency outside of banks), the money supply had been more than tripled up to April of this year to \$202.3 billion. This increase in the money supply is overwhelmingly the main reason for the rise in prices and living costs in the period.

How does it come about that a Republican administration, manned in the main by conservatives, and originally determined to halt the New Deal-Fair Deal inflationary policies, should end by continuing most of them? It is because the more politically powerful and belligerent section of public opinion, represented by CIO leaders, farm organization leaders, many business leaders and college professors, have become habituated to inflation and cannot tolerate its termination. Today, at the slightest sign of readjustment, we get the jitters and talk about another major depression.

We are all Keynesians now. We are all monetary inflationists. And everything would be fine if the Keynesian theory were really true that full production and employment could be uninterruptedly maintained, and no dangerous or debilitating consequences would follow, by the “correct” dose of monetary inflation at the slightest sign of a setback, and that all the orthodox and old-fashioned methods of readjustment were not only intolerable but quite unnecessary. ❁

## Foreign Aid Forever?

July 12, 1954

For the last six or seven years a strange performance has been annually re-enacted in Washington. The Administration in power has decided that it is somehow America's duty to provide handouts to an increasing number of nations all over the world. The Administration officials then tell Congress that the money is necessary to bring “world recovery”; “to avert world war three”; “to fight Communism,” and to get or keep allies. Most of these contentions have been pure

rhetical assertions. The simple truth is that no convincing economic case was ever put forward in favor of our far-flung economic program, and that Congress has never been given sufficient factual data on which to base an intelligent decision regarding the need and size of the military-aid program.

The so-called military-aid program, moreover, is merely another name for an economic-aid program. This is an elementary point, and yet it never seems to get any serious discussion or debate in Congress. The argument for “military aid” is at bottom an economic, not a military argument. The argument is not that Ruritania needs so-and-so-much defense, but that it cannot afford to pay for its own defense. More precisely, the argument is that while Ruritania needs  $y$  plus  $x$  millions for defense, it can only dig up  $y$  millions of its own, and it is up to us to supply  $x$  millions. Yet I have never seen a serious calculation put forward in detail for such a contention with regard to any particular nation, or the totality of aided nations.

If we supply Ruritania with  $x$  millions for defense, then Ruritania has more millions to spend than it would otherwise have. Unless we are sure that it spends  $x$  more millions on defense than it otherwise would have done (and we can never confidently answer this might-have-been) then it has that many millions more to spend, say, on deficits on its socialized industries, regardless of whether we earmark our funds for military uses.

The \$3.5 billion that President Eisenhower asked for this year’s foreign-aid program is greater than the \$2.9 billion deficit estimated for the fiscal year. If we could save this money we could balance the budget. The President pointed out that part of his proposed funds were for Europe, part for the Near East, Africa, and South Asia, part for the Far East and the Pacific, and part for Latin America. How did we ever get into the position where we thought it necessary to spend so much to support so many? And what, for example, are we now likely to get in return for the hundreds of millions we have poured into the war in Indo-China? Would not this money have been far better spent in building up our own defense program?

President Eisenhower this year recommended one good germ idea—that the new legislation should reserve for loans, rather than grants, not less than \$100 million of the fiscal year 1955 funds. It would be much better, in fact, if nearly all the aid were offered in the form of loans. International loans are in themselves no more sound politically than international grants. But if we followed, say, something like the practice now followed in private mortgage loans, and offered these

funds at, say, 3 percent or less, repayable, beginning immediately, in equal monthly installments over not more than the next twenty years, we could accomplish two substantial results. Having no large sums to repay at any one time, the foreign debtors could not start plausible complaints about the budget problem or the “transfer” problem. And there would probably be a surprising shrinkage in the size of funds requested from us.

Funds that a nation or an individual gets for nothing, whether for military defense or any other purpose, are seldom spent with much of an eye to economy and efficiency. Sums that have to be repaid are spent carefully, and only when the spender is convinced they are necessary. Most of the recipient nations can in fact afford to pay for their own defense. By such a shift from grants to loans, we would not only come far closer to getting our money’s worth, but far closer to bringing the whole foreign-handout system eventually to an end. ❁

## Mistakes of Inflationists

July 19, 1954

Two weeks ago I remarked here, hyperbolically, that we are all Keynesians now. But I could have said in sober truth that while most of those now controlling policy are inflationists, they are being pushed from behind by hyperinflationists.

A good example is the National Planning Association, a group of statist planners who manage to get their bizarre pronouncements on the front pages of leading newspapers. Their latest report declares that the country must step up its production of goods and services by “at least \$25 billion” over the next twelve months to keep the economy healthy. Why, as long as they are merely tossing out figures, stop at a mere \$25 billion? Apparently because they estimate that unemployment is still between 5 and 6 percent of the civilian labor force, that population and output per man-hour will grow, and that in the first quarter of this year the nation’s gross national product was at the annual rate of “only” \$356 billion.

This pronouncement is so typical of current inflationist fallacies that it is worth a little analysis. The NPA firmly believes that what primarily caused the recent “recession” was a drop in defense spending, and therefore what can pull us out is a boost in defense spending. Such a judgment, however, finds no support in either economic theory or experience. In the fiscal year 1944 the Federal government spent \$95 billion; in



the fiscal year 1947 it spent \$39 billion. Here was a drop in the annual Federal spending rate in this three-year period of \$56 billion. Yet, far from there being a recession in this three-year period, there was a substantial increase in employment, wages, and prices.

Nor is there any reason to suppose even in theory that wages and employment should depend primarily on the volume of defense spending, or government spending for any other purpose. If the government spends \$10 billion less on defense and *reduces taxes by the same amount*, then the taxpayers have as much more to spend as the government has less. The total volume of spending is unchanged. It would be a monstrous as well as a foolish doctrine that we must increase the volume of wasteful expenditure on armament, not for the sake of defense, but for the sake of "creating prosperity."

So far as the inflationary effect is concerned, what counts is not the amount of defense spending or total government spending, but the size of the *deficit*, and even more directly, the amount of new money supply. Even the NPA statement at one point seems willing to settle for a deficit achieved through civilian public works or even a cut in taxes. It even recognizes at one point that private plant and equipment modernization might help to create employment. But it pays scant attention to the fact that only the continuing prospect of profits, and only the ability of the profit-earners to retain enough of these from the income-tax collector, can make possible that continued investment of new capital which is essential to put better and better tools in the hands of the workers and constantly to increase their real wages.

What is most characteristic of the whole NPA statement is that its proposed statist remedies for unemployment utterly ignore the effects of wage rates. No matter how much we are inflating, no matter how high the absolute level of national income or "purchasing power," we can always bring about unemployment by pushing wage rates too high in relation to prices and sales. Yet in recent weeks, with the steel industry operating at only two thirds of capacity, the steel-workers' unions fought for and got a new increase of wages which forced a further increase in steel prices of \$3 a ton. This is not the way to assure full employment.

This points to the error in the Keynesian propensity to look only at such huge overall money aggregates as "national income" and "purchasing power." Maintenance of employment depends on expectation of profits in each industry; this expectation depends on *relationship* of costs to prices which means relationship of prices to each other and wage rates to prices. ❁

## Convertibility Now

October 11, 1954

Speaking before the joint meeting of the International Fund and International Bank on Sept. 25, R.A. Butler, British Chancellor of the Exchequer, declared that any real steps toward convertibility of the pound must depend on "more marked progress in the United States toward more liberal trade policies which would increase the dollar earning opportunities of the rest of the world. . . . We need time for the consideration of many intricate problems" before making the pound convertible.

These are extraordinary statements. So far as time is concerned, Britain has already had nine years since the end of the second world war. The pound is still inconvertible. And he was addressing his strictures to the nation that had made the British a heavy loan nearly nine years ago to make the pound convertible, and which both during the war and since then has poured billions of dollars of free grants into Britain to bolster its economy.

What Chancellor Butler's remarks chiefly reveal is the psychopathic frame of mind to which continued controls finally bring a country. It is an economic scandal that so-called free, democratic nations still retain exchange control nine years after the end of the second world war. Exchange control is price fixing in currencies. It can be maintained only by forcing exporters to turn over the dollars they earn to the government and by undisguised discrimination against American goods through prohibitions and quotas. Such a system involves at least partial control by the bureaucracy of the internal economy. Directly and indirectly it dictates how British consumers shall spend their money and what British producers shall produce.

Now British officials have formed the habit of blaming their controls not on themselves but on us. Take the supposed requirement that America must reduce its tariff barriers even further to make a convertible pound possible. It is hard to see how British officials have the hardihood to lay down such a condition. Let us grant that our customs regulations are needlessly complicated and many of our tariff rates unjustifiably high. The truth is that they are as nothing compared with the barriers to trade that Britain (and, so far as that is concerned, all the countries that have exchange control) have set up. Even if we ignore the incomparably greater barrier of exchange control, the tariff comparison alone is already in our favor. The Tariff Commission recently calculated that the American tariff averaged about 5½ percent of the value of all our imports. On the same basis, it has



been calculated, that the British tariff averaged more than 25 percent of the value of all British imports.

A few months ago Prof. Gottfried Haberler of Harvard published a carefully reasoned pamphlet, *Currency Convertibility*, explaining how and why British fears of the economic consequences of returning to convertibility are misplaced. (American Enterprise Association, Washington, \$1.) But recent reports stress a new fear not mentioned in the Haberler pamphlet. This is based on the threat of the Labour Party, if it comes back into power, to reimpose exchange control. As a result of such threats, it is said, the Conservatives have postponed their plans for convertibility from next spring till a year or two later.

But so far from this threat being a reason for hesitation, it should be a reason for the Conservative government to permit convertibility now. New-found freedom once experienced is not easily surrendered. The more free the Conservatives make the British economy the more difficult the Labour Party will find it to return to power or to push the British people back into planning and controls. Since President Eisenhower took his bold action in eliminating price controls, for example, we do not find even Harry Truman calling for their restoration. Everything points to the wisdom of Britain's returning to convertibility, at least at first, at a free and flexible rate rather than a fixed one. But such details are another story. The time to return to convertibility, in the interest of world economy, is now. ❁

## What Kind of Convertibility?

October 18, 1954

Last week I pointed out here that after nine years of exchange control, Britain has acquired a morbid fear of any return to currency freedom. Primarily this irrational dread was caused by the breakdown of the 1947 experiment in convertibility, followed by a complete misinterpretation of the causes of that breakdown. It came chiefly because Britain foolishly made a pound worth about \$3 convertible into \$4. The result was that everybody who had a pound was eager to get \$4 for it, and nobody who had \$4 wanted a pound for them. The conversion was all one way; England's gold and dollar reserves drained out alarmingly. Conversion had to be stopped after a few weeks.

Now strangely, though there is in Britain great fear of a repetition of this consequence, when the British seriously talk of restoring convertibility at all, they usually talk of restoring the same kind of fixed-rate convertibility that collapsed in 1947. They talk of restoring

convertibility at a rigid \$2.80. But this would mean either putting the pound on a dollar-exchange basis (which would be neither flattering to British pride nor very wise), or it would mean an immediate return to a fixed external gold standard, which the British are supposed to view with horror. And if the real equilibrium rate for the pound turned out to be less than \$2.80, it would mean an indefinite drain on British gold and dollar reserves.

Fortunately there is a sensible alternative. This is to restore convertibility (both of the pound and other currencies) at flexible rates, at free market rates, at what is now disparagingly called floating rates. This is what our neighbor Canada has so successfully done in the last few years. This, in fact, is what Britain itself did in the period from 1931 to 1938. When the conversion rate is a free market rate, reserves do not have to be enormous. Any one-way drain on them stops as soon as the rate for the domestic currency has fallen to the real equilibrium rate.

There has developed incredible confusion of thought about the implications of such free rates. We are told that they mean still another "devaluation." The experience of Canada, whose dollar is actually at a premium with the American dollar, should be itself a sufficient refutation of this. Whether a currency rate falls or rises is in the long run for that nation's own monetary managers to decide. If a freed pound began by falling 10 percent, say (in terms of dollars), then Britain's imports would cost about 10 percent more in terms of dollars. This would raise average British living costs. But British exports would be purchasable for 10 percent less in terms of dollars. (Or some British exporters would be able to raise their sterling prices and make higher profits.) The tendency, in other words, would be to cut down imports, to increase exports, and to bring Britain a more "favorable" balance of trade.

If the British monetary managers did not wish the pound to fall 10 percent, they could restore its value in the free market by increasing confidence in it—chiefly by making pounds more scarce, which could be done in turn chiefly by boosting internal interest rates. With a free exchange market to guide them, the monetary managers would have the enormous advantage of knowing at all times how the outside world valued the pound and what stabilizing steps to take.

Britain has asked for all sorts of assurances from the United States before it consents to go back to convertibility. But the chief external assurance it needs is not from us, but from other European countries. It needs assurance that they too will go back to convertibility to relieve undue pressure on the pound. But this is exactly

what Germany, Holland, and Belgium now seem eager to do.

Our own government should not prod Great Britain to return to convertibility. Such a return would be primarily to the advantage of Britain itself. But it is high time that we stopped subsidizing European exchange control as we have been doing for the last nine years by monetary handouts and encouragement of discrimination against American goods. ❀

## Why America Is First

October 25, 1954

There has appeared this year in France a remarkable book, by the distinguished Swiss economist Prof. William E. Rappard, under the title *A quoi tient la Supériorité économique des Etats-Unis?* (What Is the Cause of the Economic Superiority of the United States? Librairie De Medicis. Paris. 212 pages).

What makes this book remarkable, coming as it does from a contemporary European economist, is not only the generosity with which it acknowledges and insists upon the economic superiority of the United States, but the still rarer generosity with which it attributes this superiority not merely to good luck—such as great natural resources or escape from the direct destruction of the two world wars (the usual European explanation)—but primarily to the character and the free economic institutions of the American people.

“The United States is today,” writes Professor Rappard, “by far the richest nation in the world because it is by far the greatest producer of wealth. And it is the greatest producer of wealth less because its territory has been generously endowed with natural resources than because it has succeeded in deriving from the labor of its people a much better material result than its competitors in the rest of the world.”

Professor Rappard establishes this thesis with admirable lucidity and logic. He takes nothing for granted, but starts out first of all to prove beyond dispute the superior productivity of the United States. He does this by national comparisons of income, and of the output and use of scores of commodities, notably petroleum and gasoline, coal and coke, iron and steel, electrical energy, automobiles, and telephones. He proceeds to show that there has been a consistent balance of trade in favor of the U.S. maintained over many years by loans and gifts to the rest of the world.

Next he views the problem historically, and shows by quotations from foreign observers—Adam Smith in 1776, de Tocqueville in 1831, Michel Chevalier in 1835,

John Stuart Mill in 1848 and 1865, the Englishman Arthur Shadwell in 1906, and then by contemporary testimony from both American and European authorities, that the per capita production and income of the American worker has exceeded that of the European from our very beginning as a nation.

To some this proof may seem superfluous. But Professor Rappard, like a true scientist, is determined to establish his facts before he undertakes to explain them. In our higher productivity, therefore, Professor Rappard finds the primary cause of the economic superiority of the United States. He knows that the full explanation of this is complex. But he selects four main elements:

- 1—Mass production.
- 2—The application of science to production.
- 3—A passion for productivity.
- 4—The spirit of competition.

Professor Rappard places special emphasis on our internal “free market without equal on the face of the globe.” That the spirit of competition prevails far more in America than in Europe, he concludes, is beyond question. He documents this with liberal quotations from both European and American sources. He admits that there are a few American economists who deny that real competition prevails here. Though he makes what is broadly the correct answer to these, his answer could have been more conclusive had he known of and drawn upon such statistical studies as those of George Stigler and A.D.H. Kaplan.

I hope that Professor Rappard’s work can be translated into English and published here. This European sees our achievement in better perspective than most of us do ourselves. We Americans do not need to be reminded of our own economic achievement in order to be smug or boastful about it. But we do need to be reminded that this economic achievement has been the result above all of a free, dynamic, private, competitive economy. It can be preserved only by preserving this type of economy, and not by imitating the socialism, statism, and security-mindedness that have failed so dismally elsewhere. ❀

## Interpreting the Elections

November 1, 1954

On the basis of the returns from Maine and Alaska, and of their own opinion samplings, the political pundits have been forecasting a Democratic Congressional

victory. What would be the probable economic consequences of such an outcome?

These would certainly depend in part upon the interpretation generally placed on the election results. Millions of voters will vote as they do for hundreds of different reasons. Yet among the political factors now at work we may select three that are outstanding:

1—The Eisenhower Administration may be punished as much for its merits as for its defects. This is always what is likely to happen when pressure groups have been encouraged to think that they have a right to be subsidized at the public expense. Many farmers, for example, have come to feel through long custom that they have this right. The President and his Secretary of Agriculture have courageously fought the continuance of fantastic support prices that have built up appalling surpluses, drained the taxpayers of billions, and raised the cost of food for city workers. The Administration's own compromise proposals have been nearly as bad, but it may be rebuked at the polls even for its attempt to mitigate the evil.

In the last year and a half, again, the policy of the Eisenhower Administration has been inflationary. But it has not been recklessly inflationary enough to satisfy the Stevensons or the Reuthers, or to wipe out every pocket of unemployment everywhere no matter what its special cause. And for this restraint the Administration may again be punished.

2—One defect from which the present Administration suffers more than any within living memory is political amateurishness and inarticulateness. It just does not seem to know how to dramatize its achievements or defend itself against attacks. It is true that President Eisenhower has recently made a couple of speeches ably summarizing some of his major achievements. Foremost among these was stopping "the futile sacrifices in Korea." Others were abolishing stifling controls, slashing taxes by \$7.4 billions, cutting expenditures, getting the government out of some socialistic activities. Yet the President has continued and promised expansion of many New Deal programs.

3—It is this so-called middle-of-the-roadism, this semi-New Dealism, which will probably be the main cause of a Republican Congressional defeat if it occurs. It is amazing that President Eisenhower should exactly duplicate the incredible error that caused Governor Dewey to snatch defeat out of the very jaws of victory in 1948. Like Dewey, he has ignored the traditional Republican philosophy in order to go after the votes of the supposed moderate New Dealers—the so-called middle-of-the-roaders of both parties. Like Dewey, he has taken for granted the votes of the orthodox

Republicans on the assumption that they cannot vote for New Deal Democrats and therefore "have nowhere else to go." But Republican conservatives proved in 1948 as they seem only too likely to prove again in 1954—that they do have a place to go. That place is anywhere but to the polls. They can stay home, play golf, or take a walk.

This is precisely and demonstrably what they did in 1948. Only 49 million voters bothered to vote for a President in that year compared with 62 million in 1952. Truman won by default. He got the votes of only about 25 percent of the total *eligible* electorate. Mr. Eisenhower's real problem today, like Dewey's unrecognized problem in 1948, is not that the American public is hot for a return to Trumanism and New Dealism; the real problem is the indifference and apathy of conservative Republicans.

And the real danger is that a Republican Congressional defeat this year will be just as grossly misinterpreted as the Dewey defeat in 1948. It may be taken as a mandate for a resumption of New Deal spending, inflation, and paternalism of big government. The voters may collectively bring about a result that the majority of them do not individually foresee or intend. ❁

## Keynesian Thinking

November 8, 1954

Arthur F. Burns, now chairman of the Council of Economic Advisers, is one of the country's outstanding statisticians. Yet there is in his implied economic philosophy much to cause misgivings. He has, it is true, several times criticized "Keynesian thinking" (see *The Frontiers of Economic Knowledge*, Princeton University Press). Yet in this very criticism he seems to me to accept the four principal assumptions, so far as practical policy is concerned, of Keynesian doctrine: (1) That "full employment" is *the* paramount economic goal; (2) that a private competitive economy, left to itself, tends to generate from mysterious inner forces a perpetual cycle of boom and bust; (3) that it is the "responsibility" of government—tacitly assumed to be wise, disinterested, and benevolent—to pursue "contracyclical" policies to eliminate or mitigate these otherwise inherent booms and slumps; and (4) that the basic contracyclical policy is deficit spending. Let us look at these assumptions more closely.

1—In "The Frontiers of Economic Knowledge," Dr. Burns declares: "The principal practical problem of our own generation is the maintenance of employment, and it has now become—as it long should have been—the



principal problem of economic theory. This transformation of economic theory is due in large part to the writings of John Maynard Keynes." This surely sums up present fashionable doctrine. But is it true?

The principal practical economic problem of our own, as of proceeding generations, is the creation of the maximum material welfare for the great body of the people. This can be mainly achieved through maximizing the production and consumption of the right things (including leisure). Maintaining employment is, of course, one of the necessary means to this end. But to erect it into the "principal" end itself is a hopeless confusion. And as I wrote in *Economics in One Lesson* eight years ago: "Nothing is easier to achieve than full employment, once it is . . . taken as an end in itself. Hitler provided full employment with a huge armament program. The war provided full employment for every nation involved." The slave labor camps in Russia today provide full employment.

2—Now in a speech in Detroit a couple of weeks ago—on Oct. 18—Dr. Burns made what seems to me another disturbing statement. "Since our system of free and competitive enterprise is on trial," he said, "the government cannot stand aloof from the private economy but must be ready to take vigorous steps to help maintain a stable prosperity." In the last two centuries the system of free and competitive enterprise has shown itself to be the most productive ever known to man. In what sense is it still "on trial"—except in the sense in which every human institution and every human being may be said to be on trial? Is it more on trial than socialism? Or state planning? Or Dr. Burns's beloved "contracyclical policy"? The tacit assumptions in Dr. Burns's statement are not only that a free and competitive private economy cannot be trusted to be reasonably stable, but that the government—i.e., the politicians in power—can be trusted to know and to do exactly what is needed to keep it stable. Both assumptions are debatable.

3—"Contracyclical policies" is a fancy and flattering phrase, but I cannot recall any example, historical or contemporary, of their consistently intelligent, disinterested, and successful application. On the contrary, the record of nearly every government in the world, in our time, is one of recurrent or continuous monetary inflation. It is to this monetary inflation that the apparent "successes" of full employment policies are due.

4—Dr. Burns seems at one with the Keynesians, in spite of his reservations, in regarding deficit financing as one of the chief "weapons" of "contracyclical policy." But this modern superstition, if persisted in, must lead toward economic and political catastrophe. Largely as

a result of its dominance, we have had budget deficits for 22 out of the last 25 years; and the end of the deficit orgy is not in sight. ❁

## When Government Lends

November 15, 1954

The follies, scandals, and self-contradictions of government meddling in business become more apparent every day; yet Washington seems to learn nothing from them.

A recent dispatch in *The New York Times*, for example, tells us that "The Eisenhower Administration may soon decide whether to liberalize the lending policies of the Export-Import Bank to help maintain adequate world markets for United States industry in the face of growing competition." Foreign competition is now described by some exporters as "fierce." It has been "developing rapidly over the last two years in the wake of Europe's dramatic recovery." So a new scheme is being put forward for further "liberalization" of the Export-Import Bank's lending policies. The last Congressional session already increased the bank's lending authority by \$500 million to a total of \$5 billion.

The new proposal is particularly ironic when one recalls that it was the American taxpayers' money in the first place which was used to subsidize Europe's "dramatic recovery" and its present "fierce" competition. We not only poured into Europe billions of dollars of the American taxpayers' money in order to subsidize the retooling and modernization of Europe's factories (at the indirect expense of our own) but, also at the taxpayers' expense, we sedulously taught our European competitors all we could about our "know-how." Not content with that, we insisted on placing defense orders, paid for with American taxpayers' money, with European factories. For example, as was brought out recently by a contract cancellation, our government gave one contract for a destroyer escort to an Italian firm dominated by Communist workers in a majority of seven to one.

Having given away the taxpayers' money to build up European competition, Washington now proposes to use more of the taxpayers' money to help individual American exporters meet this competition.

Now not only is there no sound reason for expanding the operations of the Export-Import Bank; there was no sound reason for setting up the bank in the first place. What the bank does is to extend to foreign buyers, to finance sales to them, loans that are so dubious that neither the American exporting firm itself, nor any private American bank, will itself assume the full risk. The bank is based on the inconsistent assumption that



there are projects sound enough to risk the taxpayers' money in, though not sound enough for any private lender to risk his own money in.

This was also the basic assumption of the old Reconstruction Finance Corp. That institution finally got so involved in bad loans, scandals, and corruption that it was terminated. But Congress then blandly proceeded to set up in its place the Small Business Administration for precisely the same purpose. The chief difference is that the new agency cannot lend more than \$150,000 to any one firm. Just why the new SBA setup is supposed to involve less risk of political favoritism and scandal than the old RFC I don't know. In fact, it was precisely the big individual bad loans made by the RFC—such as the \$37 million to the Lustron Corp.—that made the front-page headlines which finally led to efforts at correction.

When government goes into the lending business a disproportionate number of loans are bound to be economically unsound. When private lenders risk their own money they examine with great care the profitability of the borrowing enterprise, the integrity of the borrower, and the chances of repayment. But when bureaucrats lend other people's money these economic aspects are too apt to get a merely formal notice and to be subordinated to political considerations. The recent tremendous Federal Housing Administration scandals, which grew out of government loans in excess of what any private agency would have been willing to grant, are merely one more illustration of the same lesson. There are half a dozen other major examples of unsound government lending. The only real remedy is not for Congress to "set up more safeguards," but to get the government out of the lending business. ❁

## Lessons of the Election

November 22, 1954

The real danger of the Republican defeat on Nov. 2 lies not in the narrow Democratic majorities themselves, but in the dominant interpretation that may be put upon the election results. The danger is that not merely the New Deal Democrats, but the Administration Republicans themselves, may interpret the result as a repudiation of President Eisenhower's more conservative policies and a public demand for return to New Dealism—to big government, big spending, inflation, and subservience to labor-union bosses.

Sober analysis, however, gives no support to this interpretation. Outstanding left-wingers, both Republican and Democratic, were certainly elected to

the new Congress; but so were outstanding conservatives. And the Administration's most successful holding operations, and even gains, were made in the farm belt. It is instructive to recall that in the early part of Mr. Eisenhower's Administration it was the opposition of his Secretary of Agriculture, Ezra Taft Benson, to the continuation of high, rigid farm-price supports that was the principal target of the Democrats in Congress and the principal fear of the Republicans from the farm districts. It seemed politically impossible that the Republicans could come out for lower subsidies than the Democrats and still keep farm support. But Secretary Benson stuck to his guns; he explained and defended his program; and he received the outspoken support of the President. The result was that the Republicans' principal electoral successes were achieved precisely where it was feared until a few months ago that they might fare worse.

An outstanding illustration is Iowa, heart of the farm belt, which elected a solid delegation of eight Republicans and no Democrats to the House, and which retired the Democratic Sen. Guy Gillette, a vigorous opponent of the Benson program, and elected a Republican, Thomas E. Martin, who defended the program. Many other remarkable Republican successes were achieved through the farm belt.

The unequivocal and courageous stand on farm policy, unfortunately, was an exception in the Eisenhower Administration. An example of quite another kind was set when Attorney General Brownell exposed the shocking record of the Truman Administration in the Harry Dexter White case, only to find his exposure virtually disowned by the President within a few days. The Administration has since blown hot and cold on the tremendous issue of Communist infiltration in the government. It has almost apologized at times for its record in removing subversives.

The Administration has been equally irresolute on the question of spending. True, it has made some substantial cuts. But it still runs huge deficits and continues indefensible spending of billions—for example, in continuing the New Deal foreign giveaway program.

Much the same may be said about labor policy. True, the Eisenhower Administration has not been shamelessly subservient to the union bosses, as was its predecessor. But though it has thereby earned the implacable opposition of the union bosses, it has failed to gain the compensating friends it needs because it has continued timorously to appease and curry favor with the union bosses rather than begin firmly to curb some of their abuses of power. Mr. Eisenhower does not yet seem to have clearly distinguished between the

interest of the small-but-vocal clique of labor-union leaders, on the one hand, and the interest of the whole body of workers (which involves, of course, the freedom of the individual worker), on the other. Not until the Republican Party grasps this distinction clearly can it hope to regain the majority of the so-called “labor vote.”

The turnover in the control of Congress was accomplished by a net shift of only twenty out of a total of 435 seats in the House, and a net shift of only one seat in the Senate as compared with the situation in 1952. Surely this is no reason for any loss of nerve on the part of the Administration, or for the belief that it can gain anything by moving farther in the direction of New Dealism. ❁

## The Giveaway Mania Grows

November 29, 1954

When Secretary Marshall proposed his grandiose foreign-aid plan more than seven years ago, even he suggested that it should cover no more than “the next three or four years.” Marshall-Plan administrators constantly assured Congress that it would not run beyond four years. But when the four years were up the foreign giveaway continued; it merely kept changing its name and declared purposes. In the fiscal year ended June 30 last, our total foreign-aid expenditures were still above \$5 billion—an amount greater than the total expenditures of the Federal government for any of the years from 1921 to 1933 for all purposes put together.

Yet the air is full of ever-more proposals for ever-bigger giveaways of indefinite duration. It is now considered the duty of the American taxpayer to support the entire world.

On Nov. 8, for example, Japan’s Premier, Shigeru Yoshida, delivered a speech before the National Press Club in Washington in which he advocated a Marshall Plan to multiply tenfold—to about \$4 billion—the amount that we should pour annually into Asia to “tip the scales against Communism.” And a few days after this speech—on Nov. 11—it was announced from Washington that the Eisenhower Administration had given its blessing to a proposed \$100 million international corporation to help finance private industrial enterprises in the so-called underdeveloped countries.

These ever-new schemes for ever-bigger handouts seem to be proof against all sober analysis and against all our experience, however disappointing. The arguments of Premier Yoshida for his new Asian Marshall Plan are depressingly familiar. Asia, he tells us, is eager to “break with the misery and poverty of the past.” This

aim, of course, deserves the sympathy of everyone in the Western world. Asia’s effort to raise its living standards, he goes on, “is hampered by a lack of capital.” But he does not stop to analyze what it is that has caused this lack of Asiatic capital, not only now, but for untold generations past. He simply leaps to the familiar conclusion that the problem can easily be solved if the American taxpayer is forced to supply that capital.

Yet he does, inadvertently, reveal the basic reason not only for the shortage of capital in Asia but for the shortage of capital wherever it exists. “The economic climate in the proud new nationalistic countries of [Southeast Asia] is not, at this crucial moment, the kind that encourages private investment.” It certainly is not. Nor, we might add, is the political climate, threatened as those countries are by Communist infiltration, subversion, or invasion. It does not follow, however, that the American government can afford to overlook what private investors cannot afford to overlook. It is folly to throw in money that might only fatten up a country for Communist conquest. And it is folly to lend money to borrowers who will not adhere to the conditions necessary to make that investment productive or repayable.

On the other hand, as soon as the would-be borrowing nations do learn and offer the conditions and assurances necessary to attract private capital, they will begin to get as much capital not only from American investors but even from their own investors as they can profitably absorb. We do not need a Point Four, for example, in order to coax private American capital into Canada.

As for the Eisenhower Administration’s new lending scheme, it is perhaps not as bad as more pure giveaway; but it is certainly not sound. It is bad enough for our government, through such institutions as the World Bank and the Export-Import Bank, to lend money to foreign governments for projects too dubious to attract private capital. But it is much worse for our government to put money into foreign *private* enterprise. Surely we should have learned enough of a lesson from the errors and scandals of the RFC loans to American enterprises, where we had enormously better facilities for continuous supervision and control, and for assuring repayment, than we could possibly have in any foreign country. ❁

## ‘Watchdogs’ for Congress

December 6, 1954

Last week I pointed out the constant tendency of our foreign giveaway schemes to grow rather than to taper

off. This tendency to expand is certainly not the result of any demonstrated efficacy in these schemes. Our billions of economic aid have not led Europe or Asia to abandon harmful governmental controls. On the contrary, they have subsidized the prolongation of such controls. There is no clear evidence, in spite of constant reiteration, that the postwar recovery of Europe has been any faster than it would have been without our aid. On the contrary, the most dramatic recovery has been made in West Germany, which was not receiving our aid. Instead of buying gratitude and dependable allies, our handouts have been accompanied by a steady loss of American prestige abroad.

And wherever our government-aid program has entered we have reduced the incentive to self-help. As long as foreign governments are assured of funds from the American Government, they will not bother to make the reforms necessary to attract private capital. Yet only these reforms can bring lasting prosperity.

Individual congressmen, certainly, are not unaware of these disappointing or harmful qualities of our foreign-aid program. But when the time comes for our foreign-aid agencies to ask Congress for a new annual appropriation, these agencies let loose a tidal wave of propaganda that overwhelms and drowns out the criticisms and misgivings of disinterested individuals. Within these agencies are hundreds of bureaucrats whose very jobs depend upon the continuance or enlargement of the foreign-aid program. Many of these bureaucrats become full-time propagandists for it. Moreover, often the officials appointed to direct the U.S. aid program abroad see themselves as fairy godmothers and forget that their easy benefactions are at the expense of the American taxpayer.

In addition, committees in Congress that have jurisdiction over foreign aid, the chairmen of which usually wish to carry out the Administration's program, call as witnesses mainly the officials of the foreign-aid agencies themselves. The minority members of the committees, or those who have misgivings about the program, have no equal means of obtaining the factual information, or the analysis, to combat the government agency's expansion arguments. A congressman is compelled to make decisions on a hundred different issues. He seldom has time to keep fully abreast even of the particular issues that he must follow as a committee member. And so Congressional decisions usually follow, by a sort of default, the recommendations of executive agencies that are clearly not disinterested.

Yet this situation could be remedied, at least in large part, if Congress were to appoint a committee of private citizens, outstanding authorities on the subject,

whose sole function it would be to study the activities of the foreign-aid agencies and report to Congress their own appraisal of the annual recommendations for new appropriations and activities made by these agencies to Congress. Congress would then be assured of a systematic, authoritative, and relatively disinterested judgment of the foreign-aid agency's proposals.

A committee of the type proposed would preferably be one whose members served without salary. But it should be authorized to employ one or two full-time salaried researchers and a modest secretarial staff. This private committee should be as far as possible nonpartisan. Such an objective could probably best be assured by allowing the majority and minority members of the appropriate Congressional committees to select the makeup of the private advisory committee in the same ratio as the committee balance within Congress itself.

In fact, if a similar private year-round "watch-dog" committee were appointed by Congress to study the work and recommendations of, say, every Federal agency that spent more than \$100 million a year, the effect would be to restrain the present alarming expansion of spending programs and to save the taxpayers billions of dollars a year. ❀

## Labor Law and Gangsterism

December 13, 1954

On Nov. 25 the International Longshoremen's Association negotiated a two-year contract with the New York Shipping Association. It gave the union a 17-cent hourly wage-welfare package increase—and a union shop. The implications of this settlement are worth some study.

The old ILA was found by the New York State Crime Commission to be dominated by gangsters. The American Federation of Labor expelled it and then tried to set up a new union in its place. The National Labor Relations Board, in accordance with the Taft-Hartley Act, held an election last May. The ILA polled 9,407 votes; the AFL, 9,144 votes. Though the outcome obviously indicated heavy dissatisfaction with the record of the old ILA, it had nevertheless retained a narrow majority. And therefore, once more under the provisions of the Taft-Hartley Act, the ILA became officially the *exclusive* bargaining agent for the longshoremen. The AFL union then had no status whatever.

And now that the ILA has secured a union-shop provision, all those dissenters who voted for the AFL must once more join the ILA in order to hold their jobs. As A.H. Raskin, labor reporter for *The New York Times*,



puts it, though the record of the ILA has been one “characterized by shakedowns, sellouts, and betrayal of the union rank and file,” the AFL must now do everything it can “to persuade its members to go back into the ILA as an alternative to economic suicide.” And the union-shop status won by the ILA in the new agreement “will make it possible for corrupt forces to do far greater damage to the welfare of the port [of New York] than was possible in the past.”

Yet nobody in the Federal government has so far shown any recognition of the appalling legal implications of the whole New York waterfront episode. The present outcome was forced on the dissatisfied union members, as well as on the employers, by the Taft-Hartley Act.

We must never lose sight of the fact that the Taft-Hartley Act is merely an amendment to the Wagner Act and retains the latter’s central and most dubious provisions. It provides that any union able to secure a majority of votes from the workers in an “appropriate unit” (designated as such by the National Labor Relations Board) must be recognized and dealt with by an employer as the exclusive bargaining agent of all the workers in that unit. This provision does two strange things that the law does not dream of doing in any other field. It gives a private group a quasi-official status. It becomes *illegal* not to bargain with it. It becomes illegal to attempt to bargain with any other group. In brief, no matter how unreasonable or how intransigent the demands of this union, the employer is legally compelled to deal with it and nobody else. And by giving a mere majority *exclusive* bargaining powers it makes it almost impossible for any competing union to establish itself.

Again, though the Taft-Hartley Act begins by declaring it to be an “unfair labor practice” for an employer “by discrimination in regard to hire or tenure of employment, or any term or condition of employment, to encourage or discourage membership in any labor organization,” it ends, in complete contradiction to this, by authorizing the union shop, under which the employer is compelled to dismiss a man who does not belong to the union. The Taft-Hartley provisions in combination force racketeering unions on employers and make the individual worker powerless. He must join the union or commit “economic suicide.”

Finally, the Taft-Hartley Act and Supreme Court decisions have created a dangerous divorce and gap between a Federal decision-making power and a local policing power, and left a no man’s land in which union gangsterism can flourish. The New York police could have cleaned the gangster from the waterfront but never

did. One of their excuses has been that jurisdiction over the ILA is in the hands of a Federal agency. Yet this Federal agency is legally blind to local gangsterism, and is not equipped to halt it even if it could take cognizance of it. ☸

## Who Speaks for America?

December 20, 1954

The mania for giving the American taxpayer’s money away to foreign countries has grown to such an extent that, with some honorable exceptions, there now seem to be only three schools of thought in Washington: Those who want to pour more of the money into Europe; those who want to pour more of it into Asia; and those who want to pour more into Latin America.

The arguments of some of these groups are less distinguished for cogency than for unintended humor. No one should miss the outburst of Congressman James G. Fulton at the recent inter-American conference in Brazil: “We are handing out billions to Europe and Asia and we are offering a mere pittance to our own family in Latin America.” How the Argentine, say, got to be part of “our own family” in some sense in which democratic Britain does not deserve the term, we need not pause to inquire. More significant is the use of the fact that we are “handing out billions to Europe and Asia” not as an argument for reducing these handouts but as an argument for handing out still more somewhere else. Apparently we must give every nation or area relatively as much as the one to which we have already given the most so that no one can feel slighted. In fact, it is precisely by taking this kind of argument seriously that we have already made postwar grants or loans to more than 60 different nations.

Nor should we overlook the recent speech here of the Prime Minister of Ceylon, who told us in effect that it was up to us to support an enormous giveaway program to Asia, but that we ought not to have the effrontery to ask for anything in return. “We want economic help in abundance,” remarked the Prime Minister. “We want financial aid without being tied in strings. . . . The nations of Asia . . . do not believe the first need is a defense pact against aggression. The first aid they need is economic aid.”

None of these extravagances, nor all our jolts and disillusionings of the past, seem in the least to discourage the Administration advocates of more giveaway. Secretary of State Dulles and Harold E. Stassen, the director of the Foreign Operations Administration, are spearheading a proposed new program of economic aid



to the underdeveloped countries of Asia in the hope of “winning their friendship.”

We need not go over again here all the reasons why this program is thoroughly unsound—politically, militarily, and economically. From the economic standpoint, handouts from the American Government to the backward countries of Asia cannot do anything substantial to raise the living standards of these countries. Those living standards will not be noticeably raised until the countries of Asia learn what is meant by free enterprise and make the thoroughgoing reforms that would be necessary to permit free enterprise to flourish. Experience has shown that handouts from the American Government merely delay such reforms. They lead the political rulers of Asia to think they can get all the money they want for their statist and socialist schemes without bothering to create the economic climate necessary to attract the economic climate necessary to attract private capital.

But while these huge handouts would not help the underdeveloped countries of Asia and Latin America, they are draining and weakening us. Our tax burden is already as high as the American economy can stand. There is hardly a man in Congress who does not concede this. The Democrats are talking, not of increasing taxes but of demanding even further reductions beyond those that the Eisenhower Administration has already made.

Yet even with our present spending program, the Federal treasury is expecting a deficit in the current fiscal year, which closes at the end of next June, of \$4.7 billion. This deficit means a continuance of inflation, further undermining of the dollar, and a still higher mountain of debt. At the same time we are spending more than \$5 billion in the current fiscal year on foreign aid. Anyone who can put these two figures together ought to be able to draw his own conclusion. This is the time to diminish or eliminate the foreign giveaway program, not to dream up grandiose new schemes. ❁

## The Right to Work

December 27, 1954

On Dec. 7, speaking before the annual convention of the CIO in Los Angeles, President Eisenhower's Secretary of Labor, James P. Mitchell, showed himself even more willing to subserve the wishes and increase the powers of union bosses than any of his New Deal predecessors had done.

Among other things, he attacked the “right to work” laws now in existence in seventeen states. Under these

laws employers and unions cannot enter into contracts that make it compulsory for a worker to join a union as a condition of holding his job. Mitchell demanded that the states wipe such laws from their statute books. This speech apparently came as a complete surprise to the White House. Mr. Eisenhower declared at his press conference the next day that the Secretary of Labor had not necessarily represented the Administration's views in any part of it. On the day after this comment, Walter P. Reuther, president of the CIO, called this a “repudiation” of Mitchell, and accused the President of perpetrating a “political fraud.” “The Secretary of Labor is not a member of the Cabinet,” he said.

I hope Reuther is right, and that the President will ask for Secretary Mitchell's resignation. Nothing short of this can clear the air.

When the speech was first published, it looked as if the President, frightened by the election returns, had decided to swing far to the left on the labor issue in one more effort to woo the so-called labor vote. Reuther's savage attack indicates how futile such appeasement of the union bosses would be even if the President supported the Mitchell program. For the Republicans to adopt that program would be such a reversal of policy that they would lose the voters' respect, and with it lose far more votes than they could possibly gain.

From the standpoint of principle, the case for the Mitchell program is even worse. To compel a man to join a union as a condition of holding his job puts irresponsible power in the hands of union bosses and is a gross infringement on the individual's right to work.

Two other major issues are raised by the Mitchell stand. The first is states' rights. Recent Supreme Court decisions have taken the position that since Congress has chosen to exercise jurisdiction in the labor-management relations field, the Taft-Hartley law takes precedence in any conflict with state law, and any state law in conflict with the Taft-Hartley law is invalid. At the same time the court has been so fantastically stretching its definition of what constitutes “interstate commerce,” subject to Federal law, that it has all but annihilated the powers that the Founding Fathers thought they had reserved to the states in the Tenth Amendment. Unless there is a reversal of this trend, states' rights will soon be wiped out without the submission of any constitutional amendment by Congress. The general acquiescence in the doctrine that Congress has the right to invalidate state labor laws that apply to what is dominantly or almost wholly commerce within a state shows how far this process has already gone.

Another major point once more raised by the Mitchell stand is the hypocritical and self-contradictory nature of the Wagner-Taft-Hartley act itself. As I pointed out here two weeks ago, that act begins by declaring it to be an “unfair labor practice” for an employer “by discrimination in regard to hire or tenure or employment, or any term or condition of employment, to *encourage* or discourage membership in any labor organization.” Yet it ends by authorizing the union shop, under which an employer is compelled to discharge a man who does not belong to the union.

This contradiction can be resolved only in one of two ways: (1) Congress can repeal the Wagner-Taft-Hartley act in its entirety, leaving employers and workers once more free to make their own bargaining arrangements; (2) if Congress wishes to intervene to forbid discrimination against union members, then in all consistency and honesty it should intervene to forbid discrimination against nonunion members. As it stands today, the law merely turns the Federal government into a union-organizing agency. ❁



1955





## How to Read a Forecast

January 3, 1955

This week and next, newspapers and business magazines will overflow with forecasts of business conditions in the coming year. In previous *Newsweek* columns (e.g., Nov. 22, 1948, and Sept. 21, 1953), I have tried to explain why, though I recognize the necessity for business forecasts, I so seldom indulge in them. Business forecasting can sometimes be a help, but it can never be a science. There are two main reasons for this. One is that the facts and contingencies that must be taken into account to predict the future are too multitudinous for any human mind to encompass. The other reason is that, in human affairs, predictions themselves affect the future they predict.

There are much greater similarities, in fact, than most business forecasters would care to admit, between their own occupation and that of race-track tipsters. (I will get to the differences later.) Business forecasters boast of the occasions in the past when their forecasts turned out to be right; so do race-track tipsters. A race-track tipster may be right for the wrong reasons; so may a business forecaster. A tipster may falsely inform a client that a race has been fixed for a certain horse to win. That horse may win nevertheless. A business forecaster may base his prediction of a recovery or recession on fallacious economic reasoning. But as business can only go up or down, there is a 50-50 chance that his falsely based prediction may turn out to be right.

A business forecaster may contend that all his forecasts are based on careful study and analysis of available statistics and existing conditions. But this may also be true of the forecasts of an intelligent racing analyst. The latter may know everything there is to know about the past records of all the horses involved, supplemented by honest fresh information from owners or trainers. On this basis he can of course make more intelligent and informed guesses than persons who lack his information. Nevertheless he cannot predict the outcome of any race with certainty. All we can say is that the informed racing analyst will on the average stand to do much better than the uninformed. Though he will never know certainties, he will know much more about probabilities. And that is the best we can say for the most intelligent and best-informed business forecaster.

Moreover, the individual race-track gambler, or the stock-market speculator or the businessman, seldom stands to gain much merely by knowing such facts and probabilities as are already known by the majority of his fellows or competitors. For unusual profit or success, he must know *more* than his competitors know;

he must guess right sooner than the rest. It is common to say in the stock market that an expected future event has already been "discounted." This means that it has already been taken account of in the present price of the stock. This sort of thing also happens at the race track. Known probabilities (i.e., the composite general guess regarding the probabilities) are already embodied in the betting odds. A man who always bet on the favorite would stand to win more often than a man who bet on the long shots; but it does not necessarily follow that he would lose less money in the long run. For when he won he would win comparatively little, because too many people were right with him.

But though there are similarities between the position of the racetrack gambler and that of the speculator or the businessman, there is one vital difference. The risks in betting on horses are invented and unnecessary; the risks in speculation or in business enterprise are inherent and inescapable. Somebody must assume them. And he who assumes them intelligently confers a public benefit, whether or not that was his intention. He prevents wasteful use of resources.

So the honest and intelligent business forecaster performs a needed function. A forecaster is a nuisance only when he is cocky and self-assured, clothes his opinions in a pompous abracadabra, parades pretentious charts and mathematical formulas, and tries to give you to understand that his guesses are the verdict of science. ❁

## It Can Be Balanced

January 10, 1955

It is increasingly sad to follow the record of the Eisenhower Administration on the budget.

Just before the Republican convention of 1952, General Eisenhower expressed the opinion that the Federal budget could be cut as much as \$40 billion in the next few years. In his first State of the Union message, on Feb. 2, 1953, he said: "The first order of business is the elimination of the annual deficit." He has since successively explained why, because of this or that unforeseen condition, he could not balance the budget for the 1953 fiscal year, or for the 1954 fiscal year, or for the present 1955 fiscal year which ends on June 30. The same dismal note was sounded once again on Dec. 6 by Treasury Secretary Humphrey, when he declared that "we cannot balance the budget" for the fiscal year 1956. This statement was followed a week later by an announcement that the President would ask Congress

to cancel the \$3 billion in corporate and excise tax reductions that had been scheduled for April 1.

There is, alas, nothing novel in this record. It merely continues the record of the last quarter of a century.

In *Newsweek* of Nov. 2, 1953, in a column called "In the Sweet By and By," I presented in as full detail as space would permit the budget record of Franklin D. Roosevelt and Harry Truman. It was a record of constantly promising a balanced budget—but always for some day in the future, never now. "The plan is to reduce the cost of current Federal government operations by 25 percent," said candidate Roosevelt in 1932. "We should plan to have a definitely balanced budget for the third year of recovery," he was saying on Jan. 4, 1934, "and from that time on seek a continuing reduction of the national debt." "We approach a balance of the national budget," he was announcing on Jan. 3, 1936. And so it went.

Harry S. Truman, in his budget message of Jan. 12, 1948, promised not only a balanced budget but a surplus of \$4.8 billion for the fiscal year 1949. There was, alas, actually a deficit of \$1.8 billion. In his budget message of Jan. 10, 1949, he once more deplored deficits, and once more promised a balance. Nevertheless the deficit for the fiscal year 1950 was \$3.1 billion.

To sum the whole matter up, we have had deficits in 22 out of the last 25 years. And now we are told we must have still another.

It is not true. The budget can be balanced. And it can be balanced in the next fiscal year. What stands in the way is not, as apologists declare, either military or economic necessities. It is false economic theories and lack of political courage.

There is neither space nor need to go into the subject in great detail here. In April of 1954 the Committee on Federal Tax Policy, a private group under the leadership of former Under Secretary of the Treasury Roswell Magill, made a careful study and concluded that a total of at least \$8 billion could be cut from Federal budget obligations for the fiscal year 1955 without even touching defense items.

The budget is not to be cut by a horizontal slash of expenditures by 10 or 20 percent all along the line. Such proposals are hopelessly naïve when they are not plainly insincere. The chief way to cut the budget is to abandon whole categories of expenditures that are being made either because of naïve delusions (this applies to almost the whole of the \$5 billion a year we are throwing away on foreign aid) or because of sheer political expediency (i.e., the farm price-support program which raises the price of food for city workers and has created appalling surpluses).

There is unfortunately still another leading factor responsible for the continuance of deficits. This is the belief, concealed or candid, that deficits are necessary to prosperity, full employment, and re-election. It is the doctrine of salvation through inflation.

So this is how the matter really stands. Anybody who sincerely believes that the budget cannot be balanced in the next fiscal year, or that the present fantastic level of expenditures cannot be cut without danger, is a victim of delusions. ☸

## Raising Wages by Fiat

January 17, 1955

President Eisenhower's decision to support an increase in the Federal minimum wage from 75 to 90 cents an hour marks another step toward the New Deal philosophy.

If wages can be raised to any desired amount by law, without harmful consequences, why stop at a minimum of 90 cents an hour? The CIO, in fact, has been demanding a minimum of \$1.25 an hour. But why not \$1.50, \$2—or even more? The blunt truth is that insofar as a law is effective in forcing wages above the levels at which competitive market forces would fix them, it creates unemployment. Marginal firms which cannot afford the higher costs are forced to drop their marginal workers or go out of business entirely.

It is often argued that "business" (treated in such an argument as if it were a single big firm) can simply "pass on" forced wage increases by raising "its" prices. But even where competition is mild enough to permit this, the higher prices result in lower sales. These mean lower production and hence smaller employment in the firms and industries affected.

The Fair Labor Standards Act went into effect at the end of October 1938. Unemployment jumped from 8.1 million in October that year to 9.6 million in December and to 12 million in January 1939. In 1949, President Truman demanded that the legal minimum wage be boosted from 40 cents to 75 cents an hour. This went into effect Jan. 1, 1950. Unemployment rose from 3.5 million in December 1949 to 4.5 million in January 1950.

Of course the government can always resort to still further monetary inflation to enable industry to pay the higher wage rates it enforces. But in that case the higher money wages are offset by price increases and become illusory.

It is a mistake to suppose that the effects of an increase in the Federal minimum wage would be

confined to the part of the labor force now getting less than the proposed new minimum. For other workers will demand the maintenance of their existing differentials. The result must be upward pressure on all wage rates.

This upward pressure will be still more widespread because of a joker in the existing wage-hour law. This joker is a provision that the employer must pay a 50 percent penalty increase for all hours above 40 a week, *no matter what his regular rate of pay*. Under this provision, a law ostensibly passed to apply only to marginal workers and their employers has controlled in practice the wages of most of the workers of the country. The provision penalizes most, the employers who are already paying most; it rewards most, the workers who are already best off. Under it, the employer who pays his workers 75 cents an hour need pay only 37½ cents additional for overtime. But the employer who pays his workers \$2.30 an hour must pay \$1.15 an hour additional for overtime.

Of course this absurdity could be cured if those who now insist on boosting the regular minimum-wage rate to 90 cents an hour would at least consent to fix the minimum overtime-wage rate above 40 hours simply at \$1.35 an hour, leaving workers and employers free to negotiate higher regular or overtime wages.

What really needs to be done at this time, in fact, is not to increase further the Federal government's meddling with wage rates, but to reduce the absurdities and contradictions in existing legislation. One of these absurdities is the Walsh-Healey Act. This law, passed in 1936, two years before there was any general wage-hour act, authorizes the Secretary of Labor to fix minimum wages in companies that are awarded Federal contracts. Under this law, a series of mischievous rulings have been made by successive Secretaries of Labor. Secretary Mitchell is now trying to force a minimum rate of \$1.20 an hour on textile companies working on government contracts. It is senseless, and violates the whole principle of nondiscrimination, to have *two* minimum wage laws which enforce entirely different wage standards. Is it too much to hope that enough sense and courage exist in Washington to remove at least this absurdity? ❀

## The New New Deal

January 24, 1955

About a year ago (*Newsweek*, Feb. 15, 1954) my article in this place carried the title "Ike's Semi New Deal." The present headline conforms to the new state of

affairs as revealed in the President's messages to the new Congress.

This is no mere personal judgment. It is a state of affairs acknowledged by the Democratic New Dealers themselves. The Democratic House leader, Congressman John W. McCormack, said of the State of the Union message: "On domestic matters most of it might be termed New Dealish." And the Democratic whip of the Senate, Earle C. Clements, declared: "I am glad to see him embracing so many things that the Democrats have so long stood for and on which he has been unable to get the support of his own party."

The New Deal policies now adopted by Mr. Eisenhower are so numerous, in fact, that it is easier to point to exceptions. I can think of two: Private instead of socialized electric power and flexible instead of fixed farm supports. Toward both, the President seems to take a mainly defensive attitude. His retreat from the previous farm-parity formula is so mild that we are still piling up enormous surpluses at the expense of the taxpayer and consumer. As for nearly all the other policies advocated, Harry Truman might have delivered the latest State of the Union speech, and did deliver a score of speeches like it.

Yet when Mr. Eisenhower dealt in broader generalities in that speech he paid at least lip service to a program of another kind: "The aspirations of most of our people can best be fulfilled through their own enterprise and initiative, without governmental interference. . . . Our government must not impair the self-respect, freedom, and incentive of the individual." But he followed this with an array of programs for increased governmental interference, and less freedom and incentive for the individual (particularly if he happens to be a taxpayer); for more government spending, more taxation, more deficits—in brief, for a huge paternalistic "welfare" state.

Mr. Eisenhower called for a continuance, and in some directions for an expansion, of the Truman foreign-aid and the Truman Point Four programs. He asked for a billion-dollar upper Colorado River basic development project. He outlined a \$101-billion ten-year highway-modernization program. He asked for more public-works programs; special aid to low-income farm families; more loans of the taxpayers' money to "small business"; still more government-subsidized housing; a Federal health-reinsurance program; Federal aid to build more schools. He asked Congress to raise the Federal minimum wage from 75 to 90 cents an hour and to expand its coverage. He asked amendment of the Taft-Hartley Act—in directions demanded by union-leader propaganda. He asked for a general pay



increase for all Federal workers, adoption of a “substantial” pay increase for Congress and the judiciary, adoption of a Constitutional amendment to lower the voting age to 18, and many other “progressive” or big spending programs.

Does not the President see that his program, considered collectively or by most of its individual items, is in direct contradiction to the principles he has previously preached and is still preaching? Of course, there are loopholes in his “simple rules.” To announce that “the Federal government should perform an essential task only when it cannot otherwise be *adequately* performed” is to allow wide room for interpretation of what constitutes adequacy. It is the contention of the Democratic New Dealers, for example, that private industry cannot adequately supply electric power. The British socialists even contend that private industry cannot adequately supply railroad transportation, coal, or steel. Yet how can the President reconcile his new program with his previously expressed concern for lower taxes and a balanced budget?

The new Eisenhower program raises one final question: What longer reason or need is there for a Republican Party? Do we need *two* major parties, both demanding the same huge bureaucratic paternalism? ❁

## Wonderland Trade Policy

January 31, 1955

President Eisenhower has renewed his request to Congress to extend the trade-agreements act for three years, and to authorize him, in trade-agreement negotiations, to make gradual and moderate tariff reductions over that period. Congress should grant the President these powers. But it must be added in all candor that even if it does so, its action under present conditions will prove largely academic and all but futile in bringing about the results that the President intends.

The truth is that the President’s “foreign economic policy” message is confused, and that the policies we have actually been following are self-contradictory. Mr. Eisenhower, in pleading for lower tariff barriers, bases his case largely on the wrong reasons. The main reason for reducing the American tariff is to benefit the American consumer—to enable him to buy foreign goods cheaper. But the President bases his case, as the Truman Administration did, mainly on the argument that it is our duty to lower trade barriers in order to gain the good will and increase the prosperity of foreign countries. Lower American tariffs would, incidentally, have these effects. But to stress this philanthropic

argument is far less effective politically than to stress the argument that we ought to reduce tariffs directly for the advantage of our own people.

Moreover, Mr. Eisenhower once more accompanied this request for lower tariffs with a request for continuance of our huge foreign giveaway program. This creates needless confusion and helps to give Congress the impression that more trade, like more handouts, is primarily a favor to foreigners.

On the other hand, Mr. Eisenhower wrongly separated his argument for lower American tariffs from other necessary changes without which such lower tariffs would be meaningless. He did not point out, for example, that trade is necessarily two-sided, and that European economic isolationism has been and still is a far greater barrier to its expansion than our own policy. He did not point out that European countries still directly discriminate against American goods and put them under import quotas. He did admit, rather indirectly, that most European currencies are still inconvertible; but he spoke of this as if it were an affliction imposed on them from without, rather than a policy deliberately adopted by European governments to conceal the extent of their inflation and to bolster their economic nationalism.

And finally, the President’s message did not point out, except by a vague and slight hint, that the tariff policy he recommends is directly contradicted by our farm policy. In order to protect our farm-price supports we have put quotas on agricultural imports that have created resentment in half a dozen foreign countries (to many of which we are giving aid). And in trying to get rid of the appalling farm surpluses that our government has piled up through its price-support policy, we are proposing to “dump” part of the surplus abroad, undercutting world prices and disorganizing export markets, and thereby alarming and antagonizing scores of nations.

The Randall commission, a year ago, courageously and clearly faced up to this contradiction. The President glosses over it. His flexible farm-support policy, it is true, is not as bad as the ultrahigh supports on which the farm bloc is still insisting; but even the present flexible policy will continue to do great harm. Since the middle of last year our government has succeeded in getting rid of more than \$800 million of farm surpluses, by selling them below cost, giving them away at home, or giving them away to foreign countries. But in spite of this huge loss to the taxpayer, the government on Nov. 30, through new acquisitions, still held about \$7 billion worth of farm surpluses, compared with about \$6 billion in July. If we had the courage to abolish this

program, we would make a far greater contribution to freedom of trade and to regaining the good will of foreign countries than we could do merely by acting directly on tariffs, and leaving our farm-price support policy unchanged. ⚙

Deficits without End?

February 7, 1955

Mr. Eisenhower is planning the 23rd deficit in the last 26 years. We are supposed to be pleased about this because the expected deficit is only \$2.4 billion in the fiscal year 1956 compared with an expected deficit of \$4.5 billion in the current year. Yet Mr. Eisenhower a year ago predicted a deficit of only \$2.9 billion for the current year. If events force him to write up his present estimate even as much as he has been forced to write up last year's, we are headed for a new deficit of \$4 billion. But Mr. Eisenhower's present estimates are far more optimistic all along the line even than his estimates a year ago. Raymond Moley discusses this phase of the budget in his own column in this issue. But the devices that have been resorted to are so extraordinary that I cannot forbear calling further attention to them: (1) In order to get his estimate of budget receipts up to \$60 billion, the President must assume that employment and production will be increased. (2) In order to keep his apparent total of expenditures down to \$62.4 billion, he proposes to set up special budgets (e.g., for roads and schools) outside the Federal budget. (3) The budget gives one set of figures covering the Army, Navy, and Air Force in detail. These add up to \$35,750,000,000. But for the three military services as a whole he gives a total of only \$34 billion. He deducts this \$1,750,000,000 because the Secretary of Defense believes there are possible (but unspecifiable) savings and "slippages." In other words, allowance is made for unforeseen economies but none for unforeseen spending increases!

There is, of course, always a possible margin of error in estimates of future expenditures and receipts. But that is precisely why conservative Treasury Secretaries of the past aimed at a safe surplus rather than an exact balance.

When Mr. Eisenhower presents a table of annual expenditures in the first part of his budget message, he carries it back only to 1952. This happens to be the last year with which spending comparisons are still in his favor. Had he carried back his comparison only one year more (as the appended table shows), he would have brought out the fact that his proposed spending for 1956

is \$18.4 billion *more* than Mr. Truman spent in 1951. And in both fiscal 1951 and 1952 the Korean war was going full tilt. What is most disheartening about the new budget is the whole spending philosophy implied. Mr. Eisenhower's message continues to give lip service to conservative spending principles; but his words are not supported by his program. There is, for example, the familiar device of showing as many expenditures as possible under the sacrosanct classification "national security programs." Mr. Eisenhower thereby gets a total for such programs of \$40.5 billion, or 65 percent of the entire budget. Yet this includes \$3.7 billion for foreign military aid, the excuse for most of which has vanished. Yet not even plausible perfunctory reasons are presented to explain why a now-prosperous Europe still cannot pay for its own defense. In fact, total expenditures for foreign aid are estimated at \$4.7 billion for the fiscal year 1956, which is actually \$400 million more than we are spending in the current year.

Then \$2.2 billion is to be spent for a farm-price-support program which raises food costs for city workers and makes a liberal trade program impossible; \$4.6 billion is allotted for veterans' benefits—\$219 million more than in the current year; and in the offing is a grandiose \$101 million ten-year road program.

Mr. Eisenhower has drifted far from the day two years ago when he declared to Congress: "The first order of business is the elimination of the annual deficit."

Fiscal Year	Expenditures (in millions)	Deficit or Surplus
1947	\$39,033	+ \$ 754
1948	33,069	+ 8,419
1949	39,507	- 1,811
1950	39,606	- 3,111
1951	44,058	+ 3,510
1952	65,410	- 4,017
1953	74,274	- 9,449
1954	67,772	- 3,117
1955 (est.)	63,504	- 4,504
1956 (est.)	62,408	- 2,408 ⚙

Inflation Was the Trick

February 14, 1955

The present Council of Economic Advisers is a much more distinguished body than that in the later years of the Truman Administration. This fact is reflected in an annual Economic Report that is better reasoned, more

carefully documented, more informative, lucid, balanced, and less flagrantly political than those to which we had become accustomed.

But after I have said all this, I am sorry to arrive at the same conclusion announced several times in this place over the last eight years—to wit, that a Council of Economic Advisers that makes *public* reports cannot be an independent, disinterested, and scientifically objective body but is forced to become an apologist for what the administration in power has done or has decided to do.

The reasons for this are inherent in the setup of the council. Appointed and removable by the President, and making public reports to the President, it can hardly criticize the economic policies that the administration has followed or recommend the opposite of what it knows the administration intends to do. Therefore the CEA's latest report, as I remarked of those under the Truman Administration, still "consists mainly of giving 'scientific' and 'economic' reasons for what the President has done or wants to do for political reasons" (*Newsweek*, Jan. 28, 1952).

The new Economic Report, in fact, goes down the line for every economic recommendation of President Eisenhower, however dubious, in all his other messages. I could repeat about it verbatim, with complete truth, many of the things I wrote about President Truman's older economic reports. For example: "The report was full of expressions of faith in a free economy. Yet one recommendation after another was based on the assumption that the economy would not in fact be stable without government intervention and control at a score of crucial points" (*Newsweek*, Jan. 27, 1947).

Now a government can continue for a long time to maintain the appearance of prosperity through monetary inflation. This is in fact the policy that the Federal government followed in 1954; and it is in fact the reason why it was able to turn the recession of late 1953 and early 1954 into a resumption of the boom.

This fact is not disputed; it is candidly acknowledged (but not of course under the nasty name of inflation) by the Eisenhower Administration itself. In his letter transmitting the Economic Report to Congress, the President declared: "Fiscal and monetary measures fostered an expectation of improving economic conditions and encouraged people to maintain a high rate of expenditure." The council's lengthy report is more explicit. It describes how the government increased the money supply by about \$10 billion in 1954 by cheap money policies. The "Federal Reserve Banks lowered their rediscount rates. The reserves that member banks are required to hold in support of their deposits were

reduced once again." Then, "As a result, the loans and investments of commercial banks increased by about \$10 billion during 1954 and the money supply increased further—especially in the second half of the year. Had it not been for the increased availability of credit and the easing of terms, the fast pace of . . . construction . . . would not have been attained," etc.

And later (page 100), the CEA admits that: "More than half of the overall expansion in bank loans and investments was in holdings of U.S. Government securities. These increased by about \$6 billion. . . . The increase of \$2.6 billion in total loans clearly was not due to commercial and industrial loans. . . . These loans were still lower at the year end than they had been at the end of 1953. The increases in the total were in large part the result of increases in real-estate loans, in loans to brokers and dealers, and to others for purchasing and carrying securities, and to a minor degree in agricultural loans." But after this admission of the way in which government policies stimulated a booming stock market, the CEA and the President deplore the "overemphasis of speculative activity!" ❁

## Time for Reappraisal

February 21, 1955

If developments in Russia, France, or Formosa force an "agonizing reappraisal" of our foreign policy, they call no less for reappraisal of our foreign economic policy. Yet this reappraisal need be agonizing only in the sense that it may force some of us to abandon a few of our pet ideas.

The necessity for diverting more of our military resources to the protection of Formosa must increase our expenditure in that direction. But this need not mean that our total budget expenditures must be increased by the same amount or even that this total must necessarily be increased at all. The need for more expenditures in one direction underlines, rather, the need for more economy in other directions.

Yet this need is getting almost no attention. Army partisans are using the Formosa crisis for a dubious insistence on more foot soldiers. And our armchair strategists are somehow certain that even a defense expenditure of \$40.5 billion a year is not enough. One of their most persistent fallacies is the assumption that the amount of defense we get is directly measured by the amount of money we spend. This assumption has survived repeated exposures of shocking misdirection and waste in military spending before Congressional committees.



Foreign economic policy cannot be treated in a separate compartment from foreign political, diplomatic, and military policy. What is needed especially at this time is a clarification of our whole relationship to our so-called “allies.” Since the end of the second world war this relationship has been strangely one-sided. We have showered other countries with money, goods, armament, and agreements to defend them. We have asked and got in return only the vaguest assurances regarding what they will do in a crisis to help defend us. One of the chief purposes of having military allies has always been to economize the use of one’s own resources—to have others share the burden of defense or war. But our own so-called alliances have been one-way contributions and assurances that have increased, not reduced, our defense expenditures.

This applies to the nearly \$50 billion that we have thrown into foreign aid since the end of the second world war. It applies to the \$4.7 billion that we are planning to spend in the same way in the next fiscal year. Almost the whole of this new sum, at least, could be saved. We must of course continue to give aid in certain special situations, as in Korea and Formosa. But there is no earthly reason why we should continue to bribe a now-prosperous Europe to defend itself, or continue the Truman giveaway program known as Point Four. We need not go again into all the fallacies and follies that lie behind our foreign-aid program. I have already done this in scores of *Newsweek* articles over the last eight years, as well as in a book, *Will Dollars Save the World?* (1947), and in a pamphlet, *The Illusions of Point Four* (1950). (Both published by the Foundation for Economic Education, Irvington, N.Y.) Fortunately there is now a growing recognition of the futility of our foreign-aid program. One evidence is the appearance of such new books as *The Dollar Dilemma: Perpetual Aid to Europe?* by Melchior Palyi (Regnery; \$2.75) and *Billions, Blunders, and Baloney*, by Eugene W. Castle (Devin-Adair, \$3.50).

The fantastically one-sided nature of the “alliances” we have made was glaringly exposed in the Korean war. It was a “United Nations” war. But the United States supplied not only more than 90 percent of the money, but (apart from South Korea itself) 90 percent of the men and casualties. Yet when it came to deciding how we were to conduct this war, and what the truce terms were to be, our token allies had apparently as much to say as if they had shared equally in the blood, sweat, and tears. We suffered, in brief, all the disadvantages of an alliance with none of its advantages. Such a situation should never be allowed to occur again. If we are now forced to carry alone the burden of defending Formosa,

we can at least stop wasting subsidies on European countries that seem apathetic even about defending themselves. ❁

## Truth Must Be Repeated

February 28, 1955

In his attitude toward the Dixon-Yates contract, Mr. Eisenhower has been merely defensive. He has made no counterattack against the fanatic devotees of socialized electric power. In the world of party politics this is losing strategy.

Occasional and reluctant defensiveness is even less likely to succeed with relentless enemies like Communist Russia and its satellites. Hardly a day has passed in the last ten years in which the leaders of these countries and its official press have not vilified the United States and the whole “capitalist” world. Yet our official answers have been sporadic, often timid, and nearly always merely defensive.

True, we have the Voice of America. The United States Information Agency is spending \$77 million this year and wants to spend \$86 million next year. But it is impossible to believe, in the face of results, that this spending has been very effective. On its face it is not reasonable to expect too much, for example, even if we do reach a few isolated and helpless men and women behind the Iron Curtain through their short-wave sets.

What really needs to be done would not cost the taxpayers an extra cent. Yet, ironically, we are not doing it. We should make a full, daily, public reply to every Chinese or Russian Communist attack upon us. Our government would not need to put this on radio or television; it would broadcast itself. Its primary purpose should be, not to “penetrate the Iron Curtain,” or to convince a Khrushchev or a Chou Enlai of the error of his ways, but *to convince and solidify the opinion that we can and do reach—that of the non-Communist world.*

What the American Government needs to provide today is systematic propaganda on behalf of the true opposite of Communism, which is free enterprise—or (to use the smear word invented by Marx) capitalism. Our spokesmen occasionally do defend something that they vaguely call “democracy.” This makes little impression, because the Communists call our democracy “capitalism” and reserve for their own political system the name of “people’s democracy.” What we must defend in our system, if we ever hope to win the ideological war, is the element of freedom in it—particularly freedom of private competitive enterprise, because it is precisely



this that is the contrary of Communism. When we do defend capitalism against the Communists or some of our socialist “allies” we usually apologize for it. Almost invariably we defend it on the ground that it is enormously more productive than socialism or Communism. This is true; but it is merely a derivative benefit. And it is precisely this kind of defense that tends still further to convince both socialists and Communists that capitalism is materialistic and soulless.

We forget, in making this materialistic defense, that the Communists are imbued with a quasi-religious zeal for their monstrous system. What makes so many of our own fellow travelers apparently incurable is their fixed belief that somehow, whatever its errors, Communism represents a higher moral ideal. So we must base our defense of capitalism not on its immensely superior production, but primarily on *moral* grounds—on its respect for the self-dependence, freedom, and dignity of the individual.

The next few years will be extremely difficult years for the Western world. If it is confused and internally divided in its ideology it stands in gravest danger of defeat. Its central economic doctrines must be clarified. Its social faith must be unified. A cold war with Communism, or even a shooting war with Communism, will still be half an ideological war, half a propaganda war. Unless our own philosophy is coherent we cannot sow doubt among our Communist enemies. The Communist world threatens to destroy civilization today, not because the majority of its active inhabitants are innately any more wicked than the rest of us, but because they believe in absurdities. It is this belief in economic absurdities that causes them to commit political crimes. Our chief hope is that we can shake their insane logic before it has plunged the world into an insane war. ☸

## The Salaries of Congress

March 7, 1955

It was a disturbing symptom when the House and Senate, by big majorities, rushed through fat increases in their own pay, effective immediately, raising Congressional compensation from \$15,000 a year to \$23,750.

There may be good arguments for an increase in Congressional salaries. But that is beside the present point, which is whether congressmen ought to raise their own salaries during their own unexpired terms.

The history of Congressional pay is instructive. In 1789 the compensation of senators and representatives

was fixed at \$6 for each day's attendance; in 1815 at \$1,500 a year; in 1817 at \$8 a day; in 1855 at \$3,000 a year; in 1865 at \$5,000; in 1873 at \$7,500 (reduced to \$5,000 again in 1874); in 1907 at \$7,500; in 1925 at \$10,000; and in 1946 at \$12,500 plus \$2,500 for expenses. The increase of March 3, 1873 (also retroactive, as in this year's House bill, to the beginning of the Congressional term), was denounced by the country as a “salary grab”; and on Jan. 20, 1874, it was repealed.

For congressmen to raise their own salaries during their own terms is not contrary to the letter of the Constitution, but clearly contrary to its spirit. Two explicit provisions are relevant. One is Article I, Section 6: “No senator or representative shall, during the time for which he was elected, be appointed to any [Federal] office . . . which shall have been created, or the emoluments whereof shall have been increased, during such time.” The purpose of this is plain. The Constitution provides, again (Article II, Section 1): “The President shall, at stated times, receive for his services a compensation which shall neither be increased nor diminished during the period for which he shall have been elected.” The purpose of this should also be plain on its face. Any doubt is removed by the contemporary explanation of Alexander Hamilton in “The Federalist” (No. 73) that it was inserted precisely that Congress should not be able to “tempt” the President “to surrender his judgment to their inclinations. . . . They can neither weaken his fortitude by operating on his necessities, nor corrupt his integrity by appealing to his avarice.” But the Founding Fathers could not foresee everything; and so they neglected to limit the power of congressmen to change their *own* compensation. But surely the same considerations that led to the constitutional provisions just cited would indicate that the President ought not to curry Congressional favor by asking Congress to raise its own salaries. They would also suggest that Congress, when it does see fit to raise Congressional salaries, should make the increase apply, not to congressmen already in office, but only to those to be elected in future. Is this too much restraint to ask? Are congressmen's necessities too great for them to get along on their recent salaries for the next two years? How many of those who voted to increase their own pay explicitly notified the voters during the election of their intention to do so?

This brings us to an even more serious aspect of the self-salary-raise. Congress for the last quarter-century (and the present Congress has not yet shown itself to be any exception) has tolerated, encouraged, and helped to create constant deficit financing and continuous

inflation. It has acted on the assumption that almost any problem, domestic or international, can be solved at the expense of the American taxpayer.

When it is suggested that the exorbitant personal or corporate income-tax rates might be slightly reduced, Congress, with a shrug of the shoulder, has expressed perfunctory sorrow that it cannot be done now. But now it pleads that the inflation it has itself encouraged and helped to create has raised its own cost of living to a point where it must raise its own salaries for relief. If congressmen can continue to inflict inflation on the rest of us, and escape the consequences for themselves by raising their own pay, what hope can the country have for a cut in spending, a cut in taxing, or a halt to inflation? If more congressmen had seen the subject in this light, fewer might have voted to raise their own pay. ❁

## Deficits Are Poison

March 14, 1955

President Eisenhower was thoroughly justified when he called the Democratic proposal to cut everybody's income tax by \$20 (plus \$20 more for each dependent) "the height of fiscal irresponsibility."

This is in effect the same proposal Democratic leaders made a year ago to raise everybody's personal-income exemption by \$100. It has all the disadvantages of that former proposal. The deficit for the current fiscal year is estimated at \$4.5 billion; for 1956 the deficit is already estimated (optimistically) at \$2.4 billion. This \$20 cut proposal would raise the annual revenue loss by \$2.1 to \$2.3 billion more. Hardly less serious, it would relieve some 5 million more voters of the necessity of paying any income tax at all, and so relieve them of any concern about governmental extravagance by fostering in them the illusion that "the other fellow" was paying the bill.

What makes this proposal even more irresponsible is that it was tacked on as a rider to a bill designed to maintain excise and corporation tax rates, so that revenues from them would not fall by \$2.8 billion a year. The Democrats said in effect to the President: "If you want to keep this \$2.8 billion of revenue we will charge you \$2.3 billion for the privilege."

This was demagoguery outsmarting itself. Even should the rider be passed by Congress in some form, it is politically easy for the President to veto it. He would stand, at worst, to lose only about \$500 million net in revenues. And economically this would be in every

way a better tax cut than the one the Democrats proposed. A cut in the excise taxes would stimulate sales. A cut in the onerous corporation taxes would stimulate investments that create jobs. And Mr. Eisenhower could accompany his veto with a reiterated demand that Congress pass his tax-maintenance proposal in its original form. If the Democrats refused to do so, *they* would find themselves bearing the onus of "favoring the big corporations."

But how did Mr. Eisenhower get into this difficulty in the first place? By abandoning the goal of his State of the Union message two years ago: "The first order of business is the elimination of the annual deficit." When he abandoned that, he lost his anchor and was himself adrift. At his press conference of Feb. 23 he gave an excellent description of the kind of proposal the Democrats had made. It would mean inflation. "Whenever you have inflation, the immediate effect is to hurt first the people of fixed incomes, white-collar workers . . . the person who lays aside savings in the forms of pensions, insurance plans, and savings bonds. . . . Now we are going back to deficit spending, the most insidious thing that can happen to a free economy."

True words; well spoken. But, alas, Mr. Eisenhower has himself never got out of deficit spending. He has allowed himself to be led astray by the Keynesian and New Deal doctrines of a "compensated economy," which treat an annually balanced budget as a minor and even a dubious objective. He has himself proposed huge new spending programs. This leaves him no firm ground on which to stand against the fiscal demagoguery of the Democrats. He can hope to combat it only by submitting a completely balanced budget—and for 1956.

My comment in *Newsweek* of March 8, 1954, on the Democratic proposal for an increase of \$100 in all income-tax exemptions would cover the present situation with hardly a change even in the figures: "President Eisenhower can successfully combat this demagoguery, irresponsibility, and inflation only if he takes a solid stand on principle. He cannot hold the line if he merely tries to stick by his January budget. He cannot convincingly argue that a deficit of \$2.9 billion is all right but a deficit of \$5.2 billion is all wrong. He can succeed only if he stands on the firm economic and political principle that the budget must be fully balanced, and *now*. And then he can demand of any group in Congress that wants the fun of cutting taxes that it first of all cut expenditures by the same amount. The only alternative to this course is economic and political demoralization. ❁"

## To Get a Responsible Budget

March 21, 1955

The Democratic proposal for a \$20 cut in everybody's income tax is the most disturbing example so far of the almost complete fiscal irresponsibility in Washington.

The Federal budget has become a political football. Fiscal responsibility has been forgotten in a sordid scramble for partisan advantage. For this situation neither party can escape blame, nor can the Congress or the President. Mr. Eisenhower in January submitted a budget which carried the 23rd deficit in the last 26 years. We were supposed to be gratified because this deficit was "only" \$2.4 billion. Yet a year ago the President estimated a deficit of \$2.9 billion for the current fiscal year, which is now estimated at \$4.5 billion. The deficit for the new fiscal year seems even more underestimated than the last one. In addition, Mr. Eisenhower has proposed huge new spending programs on schools and roads outside the Federal budget. Even without the proposed Democratic cut, the budget deficit threatens to reach \$4 billion.

This is what made it so difficult for Mr. Eisenhower to present a convincing case against a Democratic proposal that would have raised the deficit by at least \$2 billion more. In the present situation, in fact, only a handful of men in either party dare to talk of a budget balance or of real economy.

This is fiscal demoralization. It has become all but futile to argue against specific spending schemes or the perpetual deficit. Real hope lies only in a complete reform of budgetary procedure itself. We must establish a responsible budget system.

For 22 years one man in Congress, Senator Byrd of Virginia, has stood above all the rest in the courage and persistence he has shown on behalf of economy and fiscal responsibility. He has now introduced a proposed constitutional amendment which recognizes the urgency of a reform in fiscal procedure itself. This amendment would permit Congress by law to authorize the President to veto any item in an appropriation bill, without being forced to veto the entire measure.

A similar proposal has long been advocated by outstanding leaders in both parties, conservatives and liberals alike. It was urged in 1937, for example, by Republican Senator Vandenberg, and supported then by President Roosevelt. The power of "item veto" over revenue bills is already possessed by the governors of thirty-seven states. Some of them also have the power of reducing any item.

A constitutional change of this sort would surely bring us nearer to fiscal responsibility. But it may be

doubted whether in today's conditions it would go far enough. Perhaps Senator Byrd drafted his amendment in the form he did—merely giving the President the power of item veto, and making even that subject to authorization by Congressional law—because he feared that anything stronger would have difficulty getting through Congress. Yet the most wholesome system for controlling the budget, if it could be achieved here, is that which has long prevailed in Great Britain, under which the legislative branch may reduce, but cannot increase, the total expenditures proposed by the executive branch.

A budget procedure very close to this, in fact, is prescribed by the constitution of New York State. The governor's annual budget must not only give estimated expenditures and revenues for the next fiscal year, but must be accompanied by a bill or bills containing all the proposed appropriations and any proposed new taxes. The legislature (I quote the state constitution) "may not alter an appropriation bill submitted by the governor except to strike out or reduce items therein." If the legislature wishes to increase or add any appropriation, it must be by separate items or bills "each for a single object or purpose" which "shall be subject to the governor's approval." In addition to this control, the governor is given explicit power to veto individual items in appropriation bills.

Nothing short of these combined restraints, I fear, can now give us a responsible Federal budget. ❀

## The Stock-Market Boom: Whodunit?

March 28, 1955

The present Senate investigation of the stock market reminds me of one of those whodunits in which it is discovered at the end that the crime was after all committed not by the suspects who were grilled but by the detective in charge of the investigation.

The recent extraordinary rise in the stock market is of course in large part due to the present earnings of corporations, and to confidence in the outlook for business. This confidence is in part the result of the less hostile attitude toward business taken by the present Administration as compared with its immediate predecessors. But a good deal of the stock-market rise of the last eighteen months has been due to the existence of money-and-credit inflation, as well as to the belief that this inflation will continue.

The government increased the money-and-credit supply in 1954 by about \$10 billion through cheap-money policies. The long-run overall figures speak



for themselves. At the end of 1939, the country's total money supply (as measured by total bank deposits and currency outside of banks) was \$64.7 billion. At the end of 1953 it was \$205.7 billion; at the end of 1954, \$214.5 billion.

Spokesmen for the Eisenhower Administration have argued that there was no inflation in 1954 because wholesale commodity prices stood at an index number in January 1955 of only 110.2, compared with 110.9 in January 1954, while the cost of living in December 1954 stood at only 114.3 compared with 114.9 in December 1953. There are even those who contend, in the face of an increase of more than \$24 billion in the money-and-credit supply between the end of 1951 and the end of last year, that there was a "deflation" in that three-year period, because wholesale commodity prices dropped from an average index of 114.8 in 1951 to 110.3 this February.

This illustrates the confusion we get into when we define inflation, not as an increase in the money-and-credit supply, but simply as the rise in commodity prices that is usually a consequence of such an increase. (But a consequence that may sometimes not take place.) The same confusion existed in 1929 and helped to increase the dimensions of that debacle. A standard index of security prices rose from an average of 100 in 1926 to 216 in September 1929. It was argued at the time that this certainly could not be the result of any inflation because the official index of wholesale prices had meanwhile *fallen* from an average of 100 in 1926 to 96 in September 1929. Yet monetary inflation was in fact going on. Deposits of Federal Reserve member banks rose from \$29 billion at the beginning of 1926 to \$32.5 billion at the beginning of 1929. By present standards, this overall credit increase may seem moderate. But the inflation was *pouring into the stock market*. In this respect it is only the developments of recent months that bear any realistic comparison with 1929. In 1929, brokers' loans were more than \$8 billion; today they are less than \$2 billion. This illustrates not only the inexcusable discrimination but the absurdity involved in the suggestion of some witnesses before the Senate committee that margin requirements on stocks should be raised by the Federal Reserve Board from the present 60 percent to 100 percent.

It may be, as one witness in favor of the 100 percent margin requirement insisted, that there has been a 54 percent advance in stock prices in the last sixteen months, compared with a 78 percent rise in the sixteen months before the 1929 crash. But when we take longer and broader comparisons this one hardly seems ominous. In fact, whereas compared with 1929, Standard & Poor's stock-market index shows an increase of 13

percent, the cost of living shows an increase of 56 percent, wholesale commodity prices an increase of 78 percent, and hourly manufacturing wages an increase of 225 percent.

Yet in spite of the fact that security prices have lagged far behind the general price rise, there are outcries from a Harvard "economist" and a former Federal Reserve official for still further discrimination against stocks, so that stocks would become the one thing that nobody was allowed to borrow on at all. Winthrop H. Smith, the managing partner of the country's largest brokerage house, was one of the few who raised a pertinent question. If we are to eliminate borrowing on securities listed on the national exchanges, why not eliminate borrowing on homes, on all real estate, on motor cars, on furniture, television sets, air conditioners, or whatnot?

The comparison points up the demagogic discrimination to which the government has already resorted. It is now encouraging people to buy houses or almost any consumption goods or luxury on a shoestring margin. But some "economists" and senators want to prohibit people from borrowing at all if they prefer to save their money and invest it in industrial corporations—that is, in the plant and equipment that is necessary to raise the productivity of the country, to increase wages, and create jobs.

Such discrimination has reached a degree that would be comic if it were not disturbing. Installment credit now outstanding exceeds \$22 billion. This is being encouraged. Mortgage debt on one-to-four family houses has nearly quadrupled in ten years to an estimated \$75 billion. This, too, is being encouraged. But brokers' loans against stocks are less than \$2 billion. And this is so alarming that it calls for investigation and repression!

This so-called "qualitative" credit control is not only dangerous, because it permits the government to dictate just who shall have credit and who shall not, but it is also futile. Even if a man is prevented from borrowing on stocks, what is to prevent him from borrowing on his home or government bonds or his merely personal credit and using the proceeds to buy stock? We cannot flood the country with credit and throw a dike around the stock market.

And so we are back to our starting point. If the present stock-market boom is something that somebody should be blamed for, then the blame rests squarely on the Federal government itself. It is a result of its general policy of credit inflation. So the Senate investigators, if they really want to find the culprit, need not search for him somewhere in Wall Street. They need not go outside of Washington. ❁



## That Capital-Gains Tax

April 4, 1955

One good outcome of the Senate stock-market inquiry may be the public education it has provided on the effects of the capital-gains tax.

This is supposed to be a tax on capital gains. But as it is only collected when an asset is sold, it is, in effect, a tax on selling. An investor must pay, say, a tax of 25 percent on his capital gains on his shares in company X—if he sells them. As long as he holds on, he need pay nothing. If he could be *sure* that his X shares were going to fall, or even that shares in company Y were going to do relatively much better than X shares, he might make the switch in spite of the heavy tax penalty. But as he can almost never have such absolute assurance, he is likely to stay put. This is what is meant when it is said that many investors are “locked” into their investments.

The tax on long-term capital gains therefore raises comparatively little revenue. But by so heavily penalizing sales or exchanges of property, it makes holdings less liquid and the economy less flexible. It discourages people from acting in accordance with fresh knowledge or new conditions. It thereby not only distorts the relative prices of securities and other goods but prevents much capital from flowing into new enterprises or into the lines where it would be most productive. It is locked up where it already happens to be.

A great injustice of the capital-gains tax is that in an era of inflation it is a tax on gains that do not even exist. If a man bought property in 1939 for \$10,000 and sells it for \$15,000 today, he is taxed on a supposed profit of \$5,000. But this “profit” exists only *in paper dollars*. In terms of what he can buy with the proceeds *he actually has a loss*. For the cost of living has gone up 92 percent in the meantime, and wholesale prices have risen 120 percent.

Another injustice in the capital-gains tax is that it is levied by the government on the cynical principle of “heads I win, tails you lose.” For the government taxes capital gains without allowing corresponding deductions for losses. True, it allows deduction of capital losses from capital gains. But though it taxes short-term capital gains, for instance, up to any amount just as if they were income, it allows no more than \$1,000 deduction of capital loss against income. This negligible pretense of balance does not change the cynical unfairness toward investors with heavier net losses.

Senator Fulbright asks, even today, why even long-term capital gains shouldn't be taxed as straight income. The question reveals his ignorance of the history of this measure. The government once did treat both capital

gains and capital losses for tax purposes exactly like income. And it was appalled at the results. When the stock market fell from 1929 to 1932 Federal revenues collapsed—because taxpayers deducted their capital losses even from their already reduced incomes.

The crucial revelation came on May 23, 1933, when the famous banker J.P. Morgan disclosed before a Senate committee that he had paid no income tax for the two preceding years. The reason was simply that his capital losses had exceeded his income in those years. But the very idea that J.P. Morgan could skip income tax for any reason at all so shocked headline writers and congressmen that it was decided to change the law. An honest change might have been to treat capital gains and losses as the British Government does. By and large it neither taxes gains nor allows losses to be deducted against income. But our own government insisted on eating your cake and having it too. It in effect decided, (with trivial qualifications) to tax its citizens' net capital gains and ignore their net losses.

It is easier to point to the inequities in the present tax treatment of capital gains, and to the harm it does, than to suggest an acceptable alternative. The truth is that when a country has progressive income-tax rates running up to 91 percent, it is impossible to work out any fully satisfactory solution of the problem of capital gains and losses. But probably the best solution is that adopted in Britain. ❁

## Double-Taxation Blues

April 11, 1955

As he gropes and calculates and curses his way through his income tax, the taxpayer is apt to curse the wrong man. When he is asked for his Social Security number or some other information in a space obviously too small to hold it, his wrath turns on the bureaucrats who framed the forms. But sober second thought should convince him that the main culprits have been his elected representatives who framed the laws the bureaucrats must apply.

It is the complications in the law that cause the complications in the income-tax blanks. Nearly all these complications arise from the fact that our lawmakers refuse to grant to persons with high incomes the deductions which, as a matter of simple fairness, they grant to persons with moderate incomes. If capital gains are to be taxed as if they were income, then capital losses should be fully deductible from income. But Congress arbitrarily limits the deduction to \$1,000. If medical expenses above a certain amount are fair and proper

deductions from taxable income, then they should be fully deductible above that amount. But Congress and New York State put an arbitrary limit on the deduction. If, finally, it is wrong in principle and harmful in consequences to tax the same income twice, then it is wrong to remove double taxation on a few moderate incomes but retain it on higher incomes.

The calculations that the taxpayer must go through in order to figure the amount of tax relief he is allowed on income from dividends are so fantastically complicated that a new Mark Twain or Bob Benchley could not think of anything more absurd. Yet after the taxpayer is all through, he can only exclude \$50 of income from his dividends and get a tax credit of 4 percent on part of them.

These complicated calculations are necessary simply because the last Congress, in granting this merely token relief from double taxation of dividends, was in deadly fear of the accusation that rich stockholders would benefit from it. Yet from a political standpoint the Republican Congress responsible for the token relief gained nothing from all its super-caution. The CIO bosses and the Democratic dervishes are still shouting that the Republicans allowed rich men tax deductions on unearned income from dividends but refused to allow poor workers to make any corresponding deductions in income from wages.

If the Democrats should now try to throw out this dividend tax relief, in the form in which it now exists, the Republicans would be well advised either to let them do it or to offer an amendment of their own.

The double tax on corporate dividends is still flagrant. If a man invests his money in a corporation he pays a tax of \$52 out of every \$100 that his investment earns *even before he gets it*. Then, on the \$48 that is left (or whatever part of it is paid out to him in dividends), he must pay a tax of up to 91 percent (now minus a 4 percent credit). On any dividend on which he pays the maximum tax rate he has only \$6 left for himself out of every \$100 the corporation earns. The government grabs the other \$94.

Instead of giving the individual taxpayer this extremely complicated but negligible relief on his own tax, it would be much simpler all around to tax corporations themselves in a slightly different manner. Instead of requiring them to pay a 52 percent tax on their total net income for the year, for example, they could be asked to pay 52 percent on the amount of net income they retain, and, say, 48 percent on the amount they pay out in dividends. (In 1954, corporations had profits before taxes of about \$35 billion, from which they paid out \$10 billion in dividends.)

This would be an approach toward the British system of corporate taxation. Such a change in system would save the individual taxpayer an enormous headache, would be easier to explain to the inexpert, and would take phony issue away from the Democratic left-wingers. The individual taxpayer would once more pay precisely the same rate in his own tax bill on income received in the form of dividends as on any other income. ❁

## Competition in Spending

April 18, 1955

The proposed constitutional amendment of Senator Byrd would make it possible for the President to veto any item in an appropriation bill without being forced to veto the entire measure. This would surely bring Washington much nearer to fiscal responsibility. But it would still fall short of that goal. We will not achieve a fully responsible budget until we are ready to accept the system that has long prevailed in Great Britain, under which the legislative branch can reduce, but cannot increase, the expenditures proposed by the executive branch.

The proposal that Congress should actually deprive itself of the power of voting appropriations not proposed by the President is so contrary to what we are accustomed to that it may strike some readers as shocking or chimerical. Yet it is our own Federal procedure that would seem shocking in most foreign countries. They simply could not afford the fiscal irresponsibility of the American system. Nor can we ourselves afford it much longer.

The rule that the legislature should not be allowed to increase expenditures beyond those proposed by the executive is not novel. It is accepted, in fact, in the overwhelming majority of governments in the world today. It prevails in many of our own states.

The rule rests on a fundamental principle of government. The only proper fiscal function of Congress is to be the watchdog of the people's Treasury. Its members will not properly perform their function as watchmen if they can put their own hands in the Treasury. The Congressional "power of the purse" properly consists solely of the power to guard or to refuse the purse.

If this principle could once be established it would end forever the present shocking competition among the President, the House, and the Senate, and among individual representatives and individual senators, to outspend each other—to prove that each can be more generous than the others in appropriating the taxpayers'

money. If members were unable to introduce measures proposing handouts the change would leave unborn most of the bills now introduced. It would forever end logrolling. Congress would exercise far more than now its power of reducing proposed Presidential expenditures. As H.J. Ford put it in his *Representative Government* 30 years ago: "There is no propensity of human nature more marked than jealousy of opportunities that one does not share."

We may put the political principle involved in another way. It is to encourage competition between the President and Congress in economy; it is to discourage, preferably to the point of making it impossible, competition between them in extravagance.

But why, some congressmen will ask, should this power be taken away from Congress, and not from the President? The answer is that Congress already can exercise an absolute veto over any appropriation proposed by the President (simply by refusing to vote it), whereas the President cannot exercise such an absolute veto over Congressional appropriations. He does not even have the power of item veto, which Senator Byrd wants to give him. And even if he had it, he would still have, as now, only a partial "veto" which can still be overridden by a two-thirds majority in both houses. This power to override has often been exercised by Congress in granting veterans' bonuses or lavish Federal payroll increases. It tempts the President in advance to increase his own spending proposals.

If Congress could be persuaded to pass a self-denying constitutional amendment depriving itself of the power of increasing the President's proposed expenditures, it should at the same time give itself the explicit power to return an unbalanced budget submitted by the President with directions either to balance it or to reduce its proposed total expenditures to some specified maximum.

To repeat, the basic principle to be followed to attain a responsible budget is clear. It is to eliminate the power of either Congress or the President to spend without restraint and to increase the power of each to restrain the spending of the other. ❁

## Who Will Guarantee Business?

April 25, 1955

American workers are now getting by far the highest wages paid anywhere in the world. They are the highest wages ever paid even in American history. The aristocrats even among American workers are the automobile

workers, who today get an average of \$2.24 an hour and more than \$96 per week.

Walter P. Reuther, head of the United Auto Workers CIO, who has never understood, and never tried to understand, what has made possible the miracle of American wages, has decided to plump for a guaranteed annual wage. The worst thing that could happen to American labor would be to win such a demand.

The first thing to be understood about the employer is that he is merely a middleman, a go-between. He can never pass on to workers more than he gets from consumers. The employer cannot guarantee an annual wage to his workers unless consumers will guarantee him the required volume of sales. The late Philip Murray, Reuther's predecessor as head of the CIO, understood this. "Experience to date," he wrote in 1940, "raises doubt as to whether annual-wage plans can be extended over a wide area of business activity, for back of their success is the stabilization of operations."

The paradox of the guaranteed annual wage is this. When a company's volume of business is really stable all year round, there is no need to insist on a guaranteed annual wage. Steady employment and the annual wage will exist anyway. But where the volume of sales fluctuates widely, it is impossible to guarantee an annual wage. In the automobile industry the best selling season is usually spring, and manufacturers must gauge production closely to current demand.

Reuther's childish theory is that if he can force the employer to pay an annual wage he can "force" him to stabilize his sales. He forgets that it is already strongly to the employer's interest to stabilize his sales to the best of his ability. This enables him to keep his skilled working force intact, to maintain its morale, and to hold down his hourly wage rate. (Durable goods industries, less stable than nondurable goods industries, today pay wages averaging 28 cents an hour more.)

It is important to notice that Reuther is demanding guaranteed pay rather than guaranteed *employment*. What he proposes is not steady work, but that men be paid for not working. One of his slogans reads: "40 Hours Pay Any Week You Work—52 [Weekly] Paychecks If You're Laid Off."

The Reuther plan might more accurately be entitled: A Plan to Undermine the American Enterprise System and to Cripple the Companies on Which You Depend for Employment. For the first effect of his plan would be to penalize and discourage the expansion that has been the life of American business. If the employer had to pay for an entire year's idleness to every man who had worked for him two or more years, he would be extremely reluctant to take on workers who might



become such liabilities. He would rather miss sales than take such a risk. This is not only common sense; it is proved by experience. After the second world war, Italy passed a law that virtually prohibited the layoff of workers. Dismissal of workers there is still subject to very heavy separation pay. The result is that Italy has had heavy chronic unemployment for years. Its labor leaders blame the result on everything but this glaringly obvious cause.

The guaranteed annual wage, in brief, would hurt most of all the very workers it is designed to protect. It would make even the American economy stagnant. It would bring permanent unemployment. It would eat up the reserves that now provide the new equipment which by increasing American productivity in the past has enabled us to pay the highest wages in history.

And the demand for a guaranteed annual wage hasn't even a plausible excuse. We already have nationwide unemployment insurance. Reuther's guarantee is to be thrown on top of this. It is designed, in fact, to allow a man to "maintain the same living standards as when fully employed," thus removing his last incentive to get another job. ⚙

## When Government Lends

May 2, 1955

Our direct official government debt is \$277 billion. This in itself should be colossal enough to disturb any citizen who studies its implications. But the Hoover commission, in its report of March 13 on Federal lending agencies, found, in addition, that government loans, guarantees, insurance, and contingent liabilities, created through more than a hundred different Federal agencies, totaled \$244 billion.

The commission's report made various suggestions for reducing the government's proliferating lending agencies and putting others more nearly on a business basis. Yet moderate as its suggestions were, five of the twelve commission members thought they went too far.

The majority recommendations were based in part on a report of 257 pages prepared by a group headed by Paul Grady, a partner of Price, Waterhouse & Co. This task-force report was not made public until later. It is hard to see how any member of the commission could have read it and still remained blind to the mischief and danger of government lending to private business.

Whoever was principally responsible for drafting the task-force report not only knew the principles of accounting, but had a firm grasp of both economic and political principles and a gift for pithy, aphoristic

statement. The first 25 pages are a model of what such a report should be. It would be a tragedy if it should gather dust while more billions of the taxpayers' money are recklessly "loaned" away.

The temptation to quote from this report is limited only by space. A few excerpts may indicate its quality:

"It sometimes happens that a program accomplishes its original objectives, and then continues to function ostensibly for the same but actually for other purposes." (This might be said of much more than lending programs; it is a sort of universal bureaucratic law.) "REA is an example. . . . Although more than 90 percent of the nation's farms are electrified, the sponsors of the REA program foresee no end to the need for ever increasing amounts of government loans for rural electrification." The report goes on to cite the RFC and other examples:

"Ever since the depression of the early 1930s, we have made virtually a fetish of financial security for the individual, and by our successive governmental efforts to enhance it, we have loaded more and more of the inherent financial risks of our economic life on the Federal Treasury. . . . No economic system is free from risks of loss. . . . The savings of our people must stand the losses of our enterprises if there are losses. There is no way around this, no matter how remote we are able to make the settlement appear. . . .

"We may not like to acknowledge it, but it is an essential truth that many in our society, though they may honestly wish to try, are not capable of being successful businessmen, successful farmers, or even successful home owners. The failures of such people may be personal misfortunes but there seems little justification for assessing the taxpayers to cover their losses. . . .

"It is not possible for the government to assist one competitor without placing handicaps in the path of another. . . .

"Human nature and politics being what they are, occasional windfall profits are virtually an inevitable accompaniment of government lending. Subsidies in one form or another are an essential characteristic of government lending and a windfall profit is only a subsidy grown up. . . .

"Government lending programs and government guarantee programs have a fatal attraction politically. They can be used handily to bestow favor on particular groups and persons. . . . Because it is attractive politically, government lending grows and grows. Each successive national administration offers more than the last lest there appear to be retrogression."

Finally, the task force quotes from the prophetic statement of the first Hoover commission in 1949:



“Direct lending by the government to persons or enterprises opens up dangerous possibilities of waste and favoritism. . . . It invites political and private pressure, or even corruption.” ❁

## Foreign Aid Forever?

May 9, 1955

Once a government bureaucracy has been set up to do any job whatever, it will find endless excuses for expanding, prolonging, or perpetuating that job. This is the sad history of our postwar foreign aid.

Originally urged by Secretary Marshall in 1947, to meet what was then regarded as a temporary emergency situation, foreign aid has gone on and on, from year to year, constantly changing its stated purposes, constantly changing its name, but showing not the slightest tendency to terminate or even taper off. It may come as a jolt to some readers to discover that the President is actually recommending an increase in the amount to be spent in the next fiscal year even over the amount being spent in the current fiscal year. He wants foreign aid to rise from \$4.3 billion in 1955 to \$4.7 billion in 1956. Worse than this, far from even suggesting a tapering off, the President in his letter to Secretary Dulles of April 16 made it clear that he thought foreign giveaway should be a “continuing” program under “a permanent government establishment.”

The President’s April 20 message to Congress on foreign aid gives the perfunctory and mainly rhetorical arguments for it that we have been hearing for the last nine years. The message raises a hundred doubts about details. I can mention only one or two.

It is a program for scattering the taxpayers’ money over nearly the whole world—practically to every country outside of the Iron Curtain. To a few countries, in the world as it is today, continuance of military aid is unavoidable. This now applies most notably to Formosa and Korea. The President’s message makes out a less obvious but still persuasive case for aid to Iran, Greece, and Turkey. But having mentioned these specific countries, he suddenly plunges into the wholesale and unsupported generality that it is the duty of the American taxpayer “to promote welfare and growth for the peoples of Africa.” Next we find that it has become somehow our duty to shower money all over Latin America. Where a “critical situation” exists, as in Guatemala or Bolivia, we must toss in still more. Then we must continue to give to Yugoslavia and India, though there is not the slightest assurance that these countries will be on our side when the chips are down.

This is dangerous business. To scatter aid all around the globe is not only inexcusably wasteful, but its effect must be to reduce the aid we can give, for example, to Formosa, where it is urgently needed. The argument for such indiscriminate largess seems to be that having given aid to countries A, B, and C, we must give it to D, E, and F to prevent resentment.

The President’s foreign-aid program still allots substantial funds for “economic” aid, Truman’s Point Four, and all the rest. We are told that “three out of every four dollars” in our foreign giveaway program “will be immediately spent within the United States.” This is like trying to appeal to the self-interest of an automobile dealer by telling him that if he makes you a gift of \$4,000, you will use \$3,000 of it to buy one of his cars. Yet an “economic” argument that would be rejected as ridiculous if made to a private business firm can be solemnly made to a nation.

Again, the President tells us that we cannot be secure in our freedom unless, elsewhere in the world, we destroy “the conditions under which totalitarianism grows—poverty, illiteracy, hunger, and disease.” Are these really the reasons for Communism—or any other form of totalitarianism? Germany went Nazi with less poverty, illiteracy, hunger, or disease than any country outside the United States.

It is ironic, in the light of our foreign-aid program, to compare the budgets of the United States and Great Britain. In its last fiscal year Britain had a surplus of \$1.2 billion; the U.S. will have a deficit of more than \$4 billion. In the fiscal year ahead Britain plans a surplus of \$414 million; we plan a deficit of \$2.4 billion. Yet the country that had the surplus got \$120 million of aid last year from the country that had the deficit. And we think it was Alice who lived in Wonderland! ❁

## States’ Rights and Labor Law

May 16, 1955

A thoughtful, authoritative, carefully documented, and long overdue study has just been made by Gerard D. Reilly of *States Rights and the Law of Labor Relations* (Washington, D.C.: American Enterprise Association, \$1).

Reilly is a Washington lawyer who has been Labor Department Solicitor and was a member of the National Labor Relations Board from 1941 to 1946. He begins by pointing out that “No aspect of labor law is in a state of greater confusion today than the power of the states to regulate labor-management relations.” This has

gone to the point where “parties to labor disputes are frequently unable to learn until after months of costly litigation whether their rights to relief lie in state or Federal tribunals.”

There is one provision (Sec. 14 b) in the Taft-Hartley Act in which Congress did make a clear delegation of power to the states. This allows the states to forbid any kind of compulsory union membership contracts. Eighteen states have done so. The provision has recently become the subject of bitter debate. Yet it is not the only issue dividing states’ rights advocates from union leaders. Others include the authority of state courts to grant relief against secondary boycotts, jurisdictional strikes, and coercive union picketing.

The history of Federal and state relations in this field is ironic. Prior to 1937, when the Supreme Court sustained the constitutionality of the Wagner Act, it had been assumed in previous Supreme Court decisions that only the states had authority to regulate labor relations in manufacturing and mining industries, even though the products of these industries might enter the channels of interstate commerce. But once the Supreme Court decided that Congress did have the right to legislate in this field at all, it went on from decision to decision extending its interpretation of Federal power and correspondingly restricting its interpretation of state power until it arrived at the doctrine (in 1953) that when Congress passes a law on a matter within its jurisdiction it “pre-empt the field,” and deprives the states of jurisdiction over such matters regardless of whether their laws are “in coincidence with, as complementary to, or as in opposition to, Federal law.”

This and subsequent decisions have left the subject in legal confusion. Crucial provisions of state labor laws have been struck down whether or not they were in conflict with the Taft-Hartley Act. A sort of legal “no man’s land” has been created. The Federal government has no means of policing local strikes, or of preventing coercive mass picketing or outright violence; and the Taft-Hartley Act is practically blind to the existence of such matters. In fact, in past rulings of the National Labor Relations Board or of Federal courts, assaults by pickets or the throwing of rocks have been condoned or dismissed as “animal exuberance” or mere picket-line “scuffles.” Yet Federal-court decisions have thrown a fog of doubt around the power of the states and localities to control violence and coercive picketing.

Reilly’s statement of the case is moderate in tone, and his own legislative recommendations are also moderate. He believes that Section 14 (b) of the Taft-Hartley Act, which permits the states to enact right-to-work

laws, should be preserved. And as the Federal government is not equipped to handle all labor-management problems (especially those concerned with mass picketing, sabotage, violence, etc.), he feels that the right to legislate in some of these matters should be reserved to the states and that Congress should clearly define “those areas which it intends to leave unregulated and those which it intends to leave to separate or concurrent regulation by the states.”

But the history and facts that Reilly so admirably presents raise questions that go much beyond his own recommendations. Does the Federal government, in fact, constitutionally actually have the sweeping powers of intrastate labor regulation that Supreme Court decisions of the last twenty years have awarded to it by their far-fetched reasoning? ☼

## No Need for OTC

May 23, 1955

Senator Byrd, as the event proved, showed good sense in putting aside the President’s proposal for an international “Organization for Trade Cooperation” and getting quick action to extend the Reciprocal Trade Act on its own merits.

The OTC proposal places a serious question before Congress. Indeed, it places a serious question before all those who, like the present writer, earnestly wish a lowering or removal of international trade barriers, but doubt whether the creation of one more permanent international organization is the way to get it.

Does the world need, does any single nation need, an elaborate multilateral trade agreement, requiring the consent of 34 nations, and an elaborate bureaucratic machinery, in order to lower trade barriers? Obviously not. The world has already had the old General Agreement on Tariffs and Trade (GATT) since 1947, and international trade barriers were never more fantastic. Yet prior to the first world war, and for that matter prior to the second, the barriers to international trade were far less serious than they are today. If each individual national understands that free trade or at worst only moderate trade barriers are primarily in its own interest, then each national will follow such a policy in its own interest and no international agreement will be necessary. And unless such an understanding exists within individual nations any international agreement or organization will be worthless.

The President's message to Congress of April 14, advocating U.S. membership in the proposed OTC, was not convincing. Its reference to our membership in the International Monetary Fund, for example, mainly recalls the futility, and worse, of that organization. Mr. Eisenhower's argument that OTC could "help establish conditions favorable to convertibility of currencies" is depressingly familiar. The IMF was established precisely to stabilize currencies and make them convertible; its actual effect has been to prolong for ten years completely inexcusable policies of internal inflation, external exchange control, trade discrimination, and state control of industry.

All this is not to deny that the revised GATT is in some respects an improvement over the old GATT (and of the proposed ITO), and that in it 34 nations have embodied many sound principles likely to appeal to proponents of freer trade. But the new GATT also embodies and gives official sanction to some thoroughly unsound principles.

Even the new GATT expressly denies the right to require the removal of any country's quantitative import restrictions which are the result of balance-of-payment difficulties caused by "full employment policies" or by a country's "underdevelopment." This is economic claptrap. Can we, or any nation, afford to give it official sanction? So-called "balance-of-payment difficulties" are almost invariably the result of internal inflation combined with exchange control; the country brings them on itself by its own bad policies. It is no consolation to learn that the United States succeeded in obtaining a special concession allowing it to impose quantitative import restrictions itself to protect its farm price-support program. This again gives official sanction to thoroughly unsound policies. These provisions alone, not to mention many others, are enough to invalidate GATT. Why embody this dangerous nonsense in a permanent agreement with an enforcing organization?

The OTC in fact, seems to represent just one more example, not of any real tendency toward international freedom, but a tendency to create ever new supranational bureaucratic organizations for world centralization of power. And the OTC would also deprive Congress of still more of its proper powers under the Constitution. There seems to be no good reason why Congress should vote to establish the OTC. On the contrary, it is rather time that we should start withdrawing from the thoroughly unsound international organizations, typified by the IMF, that stand in the way of freedom, stability, and sound economic progress. ☸

## Compulsory Unionism

May 30, 1955

There has lately been increased rebellion against the trend toward compulsory unionism. Opponents rest their case on the principle that no man should be compelled to join a union in order to get or keep a job. But most of the rebels are modest in their aims. What they seek (like Gerard D. Reilly, whose pamphlet, *States Rights and the Law of Labor Relations*, was discussed here a couple of weeks ago) is little more than the retention in the Taft-Hartley Act of the provision which permits the states to forbid compulsory unionism.

But if any permanent success is to be achieved in this cause its aims must go much farther. Let us begin, for example, with the Taft-Hartley law itself. It must never be forgotten that this is merely an amendment of the Wagner Act. Like the Wagner Act, it forbids "discrimination in regard to hire or tenure of employment or any form or condition of employment to encourage or discourage membership in any labor organization." Yet, in clear contradiction to this, it permits the imposition of the compulsory union shop. If the Taft-Hartley Act is to conform with its own declaration of purpose, it must forbid the employer to discriminate in favor of union workers as it forbids him to discriminate in favor of nonunion workers. It cannot permit the compulsory union shop, and it cannot permit so-called maintenance-of-membership contracts.

But any attempt to protect the right of the individual worker either to join or not to join a union would have to go much farther than this. For the Taft-Hartley Act gives a union that has gained the adherence of more than 50 percent of an "appropriate bargaining unit" in a plant or company the right to act as the *exclusive* bargaining agent for *all* the workers in that company. This right to bargain for other than its own members is a right not given by law to any other kind of private organization. As the eminent labor lawyer, T.R. Iserman, has pointed out: "The right to act as the exclusive bargaining agent of employees is far more important to unions than any right to force employees to join unions under closed-shop or union-shop contracts."

But a still further amendment would have to be made in the Taft-Hartley Act before it could become a truly impartial and workable document. Congress would have to adopt the amendment suggested by Gerard Reilly (once a member of the National Labor Relations Board), under which Congress would clearly define "those areas which it intends to leave unregulated and those which it intends to leave to separate or concurrent regulation by the states." Preferably Congress



should go even farther and leave to the states and localities all those matters, such as coercive picketing, sabotage, and violence, that the Federal government is not in a position to police. It is absurd for any governmental authority to try to lay down rules in spheres beyond which its own power of enforcement extends.

If we look at the question realistically, however, it is extremely unlikely, in view of the one-sided Washington attitude of the last twenty years, that Congress would now pass a balanced labor law which would consider first of all protection of the liberty of the individual worker to join or not to join a union, as he saw fit.

It may be asked, in fact, whether those who are now insisting that the law abolish any form of the compulsory union shop have fully studied the problems that this raises. It implies continued detailed intervention by government in the field of labor relations. Would it not be better to take the unions at their word and simply repeal the Taft-Hartley Act and return to the situation that existed in this country prior to 1935? Would it not be better for the Federal government to intervene only in undeniable interstate labor relations and leave the regulation of other labor relations either to the states or to the common law, which should protect the individual, whether worker or employer, from violence, but otherwise leave him free? These are large questions, which deserve deeper study than we have yet given them. ❁

## Irresponsible Spending

July 18, 1955

The other day Rep. Clarence Cannon, chairman of the House Appropriations Committee, made a promising analysis of some of the things wrong with our present Federal budget system and then came up with some very unpromising remedies.

At present, he said, Congress can wreck completely the best prepared budget. "Any senator can walk into the Senate Appropriations Committee and put anything in a bill he wants. Then when it gets to conference the senators say: 'You can't do anything about that—that's Senator So-and-So's item.' You'd be astounded at what some senators get away with. . . . You can go down the roll and find many members who never vote for a tax [increase] bill but for every appropriation bill. The people must be protected against that sort of statesmanship."

What then are Congressman Cannon's proposed remedies? To take away the power of Congress to wreck even the best prepared budget? Not at all. His proposed

remedies are two. One is a bill to require the President to submit to Congress a balanced budget each year. This would appear to be quite inflexible and not allow for emergencies or crises. The other remedy is a bill that would abolish the present Budget Bureau under the Executive Department and assign its duties to a new agency operating under Congress.

This second bill is even more puzzling than the first. Chairman Cannon would apparently still require the President to submit a budget, but would deprive him of his chief agency of preparation and control. It would turn the preparation of budgets over to a Congress which, on Cannon's own testimony, has been so busily engaged in mutual logrolling that it wrecks even the best prepared budget.

Much more promising proposals have been made by the Treasury Department and by the Hoover commission. Secretary Humphrey has proposed that Congress pass individual appropriation bills as at present, but not send them to the White House for signature until the overall total has been tabulated and cuts made to bring it down to the level of expected receipts. The Hoover commission has recommended that Congress stop appropriating enormous sums which may not be spent for several years, and appropriate money only for actual spending in a given fiscal year.

Unfortunately, while both of these proposals have merit, neither goes to the heart of the problem. The heart of the problem is that our Federal government has an irresponsible budget system. It is irresponsible because no single official or agency can now be held accountable or responsible for the final result. The President can recommend one set of expenditures; the House can raise them; the Senate can raise the House. This triangular competition in spending favors the localities and the pressure groups and leaves the taxpayer defenseless.

Nearly every other country has a more responsible system. In Great Britain for more than two centuries the wholesome rule has been established that Parliament may reduce but not increase any spending recommendation made by the executive government. This is the ideal. The very minimum requirement to bring us even near a responsible budget would be a constitutional amendment to give the President power to veto individual items in appropriation bills (a power now held by the governors in 37 states). Even better would be provisions such as those in the New York State constitution. These require the legislature to act on the governor's whole budget before making any appropriations on its own initiative. Such extra appropriations must be in separate bills subject to veto.



If such a reform were adopted, it would still leave room even for the adoption of Congressman Cannon's suggestions in a modified form. Congress could set up its own budget agency to maintain liaison with the Federal Budget Bureau throughout the year. And Congress could be given explicit power to return to the President any unbalanced budget and recommend that he cut spending to a specified overall sum. ☸

## Abolish Exchange Control

July 25, 1955

Since the new Conservative victory at the polls, there is once more serious discussion of Britain's abandonment of exchange control. If the government is to act, it should act now, when its victory is fresh and its prestige high, and when Labor cannot threaten to restore controls.

Recent discussion of British abandonment of exchange control has been much more realistic than the previous perfunctory discussion. It now envisages return of the pound first of all to a free or "floating" rate. Unless Britain contemplates returning immediately to a gold standard (which seems outside the realm of realistic discussion), a transitional free market for the paper pound is the only feasible method of ending exchange control. If it is ended in Britain, it will collapse in most of the rest of the world. An enormous step will have been taken back toward that interconvertibility of currencies and freedom of international trade that the world's politicians have so long professed to want—and done almost everything to prevent.

For the last ten years many of us have been hoping for some clarity, courage, and common sense on this subject in Great Britain, only to be repeatedly disheartened by the confusion or acquiescence of most British discussion on the subject. But at last the tide seems to have turned. I recently received from England a booklet of 62 pages, *The Free Convertibility of Sterling*, by George Winder (Batchworth Press; London), which is the most lucid, thorough, and uncompromising protest against continuation of British exchange control that I have yet read.

Winder has published something more effective than a mere polemic. He has written a sort of elementary textbook. It begins by explaining exactly what foreign exchange is, how exchange rates are arrived at, and how foreign payments are made. It leads by that means into an explanation of how great the injustice and folly of exchange control really is. He emphasizes especially two aspects: (1) It involves price-fixing in currencies; (2)

it involves arbitrary confiscation of the overseas earnings of a country's own citizens.

It is only by rare accident, as Winder points out, that the arbitrary price put on controlled paper currencies can correspond with the relative real values of currencies as they would be reflected in free markets. Therefore, "where currencies are sold at controlled rates, one of the parties to every transaction will inevitably receive less than he is entitled to. Someone, in fact, is robbed." The so-called "dollar shortage" was brought about simply by the underpricing of dollars. This underpricing of dollars (or overpricing of sterling) also had the effect of encouraging British imports and discouraging British exports. "Sir Stafford [Cripps], over a long period, was paying our exporters 5 shillings for their dollars when in fact they were worth 7 shillings. All the time he was robbing our exporters he was pleading . . . that Great Britain must 'Export or Die'."

Perhaps worse than this economic damage is the immorality of exchange control—its complete disregard of the individual's right to dispose freely of his own overseas earnings. "To be effective, currency laws must not only provide that people leaving a country be carefully searched, but that all overseas mail be censored. . . . All foreign currencies . . . owned by Englishmen must be surrendered to the government. There is here far more than control; there is quite literally confiscation. . . . Of course, compensation is paid but invariably it is insufficient. If this were not so there would be no need for punishment to enforce the surrender of currencies."

A crowning irony, I may add, is that under our own foreign-aid program we have not only been subsidizing exchange control in Europe, but *we have actually insisted that as a condition of receiving our aid the recipients must discriminate against American (i.e., dollar) imports!* But it does not follow that because we have been injured by England's exchange control, England has benefited. It has retarded the expansion of its essential export markets. ☸

## The Seamy Side of TVA

August 1, 1955

One wonders whether the hue and cry that Democrats have raised over an alleged Dixon-Yates "scandal" is intended to divert public attention away from the failure of TVA and from the deceptions practiced to put over and extend that and many other socialized power projects.

In the 218-page report of the Hoover commission, and in the 1,783-page report of the task force under Admiral Moreell on which the final commission report was in large part based, we now have a mine of material exposing some of the misleading estimates and unkept promises by which Congress and the taxpayers were induced to undertake many public-power projects. There is not space enough here to cite more than a few random examples from the Hoover-commission report.

Among these are the persistent underestimates of government engineers concerning the real cost of these projects. "In the field of reclamation the original estimated cost of the 90 projects (outside the Missouri Basin) was \$1,580 million, and in 1952, the estimated cost at completion was \$3,317 million. The cost of the reclamation portion of the Missouri River Basin Project was estimated in 1944 at \$850 million. In 1953, the same work was estimated at \$3,717 million, an increase of about 343 percent." Only a small percentage of these increases was owing to soaring prices.

"A report to the House Committee on Public Works, rendered by its subcommittee to study civil works, in December 1952, states that the TVA reports its costs had exceeded its estimates by only 3.1 percent. But an examination of a 1936 report of the Authority showed that later estimates for Kentucky Dam exceeded the original by 93.6 percent; for Fort Loudoun Dam, by 74.7 percent; and for Fontana Dam, by 137.7 percent."

In a group of Bureau of Reclamation proposed projects the construction costs of irrigated land averaged \$509 per acre for land that had an average market value of less than \$150 per acre even with the full water supply.

Under the Constitution, Congress has authority to control navigable streams and floods, but no discoverable right to build hydroelectric power plants. This has led to the development of the shrewd doctrine that hydroelectric power may be developed and sold by the Federal government to the extent that it is "incidental" to flood control and navigation. It has also led, as the Hoover-commission report points out, to a bookkeeping allocation of all the costs possible to flood control and irrigation rather than power.

The Hoover task group laid down certain criteria for determining the real success or failure of Federal power projects: They ought to earn 3 percent interest annually to insure return of Federal borrowing costs. The investment should be properly amortized. The projects should pay local taxes equal to those of private utilities. Earnings of Federal projects should include an amount equal to the Federal tax exemptions, based on the tax payments of private utilities. With such an

honest "yardstick," the TVA would show a deficit of \$30 million in the fiscal year 1953 and an accumulated deficit up to that time of \$100 million. The principal groups of Federal projects would show a cumulative deficit of \$332 million.

The Hoover commission points out that the Federal taxpayer is subsidizing these projects. Less than 10 percent of the total population will be directly benefited even when the programs are completed. This means that 90 percent of citizens are forced to subsidize an arbitrarily favored 10 percent. The task group estimates that the Federal projects are selling power on the average at about 50 percent below its real cost.

Finally, while hydroelectric power plants were built under the pretense that they were "merely incidental" to navigation and flood control, the TVA "has now embarked upon an expansion of its power-generating capacity beyond hydroelectric plants by the building of steam plants."

The moral indignation of the zealots for socialized power at the Dixon-Yates contract seems misplaced. ☸

## Unsound Wage Boosts

August 8, 1955

Among the measures passed by Congress was one to raise the legal minimum wage from 75 cents to \$1 an hour. The changes brought about by this measure will do more harm than good to marginal workers.

So far as basic principles are concerned, there is nothing I need add to my *Newsweek* article of Jan. 17, discussing President Eisenhower's proposal at that time for an increase in the minimum wage from 75 cents to 90 cents an hour. If wages can be raised in any desired amount by law, without harmful consequences, why stop at Mr. Eisenhower's 90 cents an hour? Or Congress's \$1 an hour? Or the CIO's demand for \$1.25 an hour? Why not \$1.50, \$2—or even more? The truth is that insofar as a law is effective in forcing wages above the level at which competitive-market forces would fix them, it creates unemployment. It does most harm precisely to the marginal workers it is most designed to help. For marginal firms which cannot afford the higher costs are forced to drop their marginal workers or go out of business entirely.

It is an error to suppose that the effect of a 33⅓-percent increase in the Federal minimum wage will be confined to the part of the labor force now getting less than the proposed new minimum. For other workers will demand the maintenance of their existing

differentials. The result must be upward pressure on all wage rates.

Congress, in voting for this measure, did not even take advantage of the opportunity to reduce the absurdities and contradictions in existing legislation. One of these is the joker in the existing wage-hour law, which provides that the employer must pay a 50 percent penalty increase for all hours above 40 a week *no matter what his regular rate of pay*. This provision penalizes most of the employers who are already paying most; it rewards most the workers who are already best off. This absurdity could have been easily cured if Congress, even when it insisted on boosting the regular minimum wage to \$1 an hour, had simply fixed the minimum overtime rate at \$1.50 an hour.

The other absurdity which Congress and the President could have taken this opportunity to get rid of is the Walsh-Healey Act. This law authorizes the Secretary of Labor to fix minimum wages in companies that are awarded Federal contracts. Successive Secretaries of Labor have used this act to force minimum-wage rates in particular firms or industries far above the general minimum-wage rate fixed under the so-called Fair Labor Standards Act. This is discriminatory legislation. It gives the country two minimum-wage laws, enforcing entirely different wage standards.

So much for the basic principles involved in the minimum-wage increase. But if ever a measure was unnecessary and ill-timed, this one is. The increase in minimum wages is being enacted at a time when wages in manufacturing industries average \$1.87 an hour—the highest level in American or world history. And this figure does not yet reflect the formidable new increases that have just been achieved in wage rates in the automobile and steel industries and elsewhere. These increases have already led to an average increase of \$7 a ton in the price of steel and are expected to lead to increases in automobile prices for 1956. Other things being equal, the effect of these wage increases, and of the consequent increases, should be to restrict the market for American products both at home and abroad, to bear heavily on marginal firms, and to cause unemployment.

The economic factors at work at any one time are so numerous and difficult to measure that the consequences of any one policy cannot be precisely predicted. Wage boosts of the present sort have in the recent past forced a further monetary inflation in order to make the wage boosts payable. That result may follow once more. But certainly the higher minimum-wage rate, on top of recent wage increases forced by strong unions,

introduce an element of weakness, not of strength, in the present economic situation. ☸

## Keynesian Confusions

August 15, 1955

The British Government has announced a retrograde step in economic policy. This is worth study both on its own account and for the light it throws on American errors.

Richard A. Butler, Chancellor of the Exchequer, moved in the right direction when on last Feb. 24 he raised the interest rate that the Bank of England charges ordinary banks a full point, to 4½ percent. This was part of a courageous effort to curb inflation. But now he is taking measures that move away from economic freedom and yet do not promise to be very effective in halting inflation. He has raised the required down payment on installment purchases on such items as motorcars and household appliances from 15 percent to 33½ percent. The purpose of this is to halt a so-called buying spree of the British public, and to correct Britain's international balance of payments by forcing British manufacturers to find an export market rather than a home market for some of these goods.

As for correcting the balance of trade, the restriction on installment credit is irrelevant to real causes. Foreign trade, left to itself, will balance itself. It will balance itself for the simple reason that sellers insist on being paid for the goods they sell. What is unbalancing British trade now is exchange control. If the pound were set free it would seek the level that would balance imports and exports. A decline in the pound, for example, would raise the cost of imports, so discouraging and contracting them. It would increase the profit margin on British exports or reduce their foreign-money cost, so encouraging and expanding them. Ironically, Chancellor Butler now gives as his reason for postponing free exchange rates the very unbalance of trade that is caused by the existing ban on free exchange rates.

Britain's new curb on installment credit (like our own Federal Reserve requirement for a 70 percent margin in the buying of stocks) is at once discriminatory, unnecessary, and futile. Installment credit, like stock-market credit, is *derivative* credit. If interest rates are raised *generally*, the whole volume of credit will be contracted or held from expanding. If, on the other hand, money is kept generally too cheap, credit must continue to expand. Governments cannot flood their countries



with credit and build effective dikes around special kinds of buying.

It is argued that the recently announced British steps are necessary because the February rise in the Bank of England discount rate to 4½ percent has proved ineffective. Bank loans, instead of dropping, rose by \$448 million more in the first six months of this year compared with the first half of 1954. But this means merely that the British bank rate is still not high enough in relation to the demand for credit. (Our own recent Federal Reserve rate of 1¾ percent was even more inflationary in relation to our own money market.) If Chancellor Butler tried a Bank of England rate of 5 or 5½ percent he might find it effective enough.

Instead of taking this well-tested traditional step, Butler has preferred an unsound alternative. He has announced that the government will frown on capital expenditures for construction of new plants or equipment, and will postpone all such expansion plans in the nationalized industries (except for coal mines and atomic power plants). This action, like the even more drastic action of Sweden in curtailing investment in plants and equipment in private industry, rests on confused Keynesian theory. Direct government discouragement of new capital investment is the worst possible way to "combat inflation."

Such discouragement must lead in the long run to higher rather than lower production costs, to less rather than more consumer goods, and to lower real wages than would otherwise prevail. The nation that follows such a policy will soon find itself handicapped in export competition with more progressive countries.

The dead hand of Keynesianism, and the fetish of "full employment," still vitiate the policies of the leading nations of the West. ❁

## Our Two New-Deal Parties

August 22, 1955

Adjournment of Congress provides an opportunity for taking stock of present Federal economic policies. One central conclusion emerges. Mr. Eisenhower, with minor reservations, is now another New-Deal president.

He has been pressing for the heart of what the New Deal stood for—big spending, big government, an ever-expanding paternalism. And the political situation is such that there is no real opposition to this pressure. We have now two New-Deal parties. Those millions of Americans who believe in economy, in balanced

budgets, in some curb on centralization and expanded governmental power and paternalism, now have no national party to represent them.

Let us illustrate this by specific items. We have come a long way from the time when Mr. Eisenhower during his campaign suggested huge slashes in Federal spending, and even from the day of his first State of the Union message when he declared: "The first order of business is the elimination of the annual deficit." He still pays lip-service to the need for a balanced budget, but this goal keeps receding into the future. As "the first order of business" it can no longer be reconciled with his actual policies.

The worst of them, from this standpoint, is his grandiose ten-year \$31 billion Federal-state road-building program to be financed by special bond issues not to be counted as part of the national debt. This failed in the last Congress through the mere accidents of partisan jockeying for position. Mr. Eisenhower also advocated Federal aid to local school construction, and Federal reinsurance of private health plans. Both deservedly failed. The Federal government has no business in either field.

Mr. Eisenhower was successful, however, in his plan to continue foreign aid on a scale even higher than last year. He wants to scatter subsidies totaling \$4.7 billion to dozens of foreign nations in a year in which we ourselves have an officially estimated deficit of \$2.4 billion! For this same year, Mr. Eisenhower also insisted on appropriations for 35,000 public housing units (and got 45,000). From any standpoint such public housing is not merely unnecessary but dangerously ill-advised. It promotes subsidies and socialization at the expense of private initiative. It increases a wholly needless deficit. And it artificially stimulates still more housing at the very peak of prosperity and a housing boom.

The President insisted on other New Deal measures. At a time when hourly wages are the highest in American or world history he asked for a boost in the minimum wage from 75 to 90 cents an hour (and got \$1). This measure will increase production costs and imperil the employment of the very marginal workers it is designed to aid. The Administration has also encouraged a whipping-up of the present boom by credit expansion, against which it is only now taking belated steps.

It is of course fair to point out that the President has taken some actions in the other direction. With the Dixon-Yates contract he tried to stop the growth of the Federal public-power colossus. But that whole contract was so ineptly handled and defended that the zealots of



socialized power think it provides them with a crucial 1956 issue. Again, the President made an effort to put some limit on the present appallingly costly, inequitable, and dangerous farm-price-support program. But here again his action has been so timid and inadequate that the situation is becoming constantly more critical.

It is also fair to point out that the majority of House Democrats supported some shamelessly demagogic measures and that Mr. Eisenhower courageously and successfully fought them (the \$20 income-tax reduction for everybody, and the slapdash social-security revisions).

Yet on balance the central conclusion remains. We are drifting, under pressure from a Republican President and Democratic Congress leaders, toward ever-expanding Federal power and paternalism. The opponents of this drift are scattered and isolated, and there is now no national party even to state their case. ❁

## A Flood of Credit

August 29, 1955

We are enjoying at the moment the greatest prosperity in our history. But this boom has been in part created, and certainly raised to its present level, by a flood of credit. The measures so far taken to moderate it are timid and belated. Only time can reveal their effectiveness.

That the present boom is at record levels is shown by almost every major index—whether of employment, production, or money income. But the government policies responsible for this boom have been ill-considered and dangerous. When a government-created boom shows signs of getting out of hand, government officials begin to shake their fingers at the stock market, at private banks, and at private business practices, as if these were responsible. Of course they must assume part of the responsibility. But in most cases, and certainly in the present case, it is government policy that has mainly determined the result.

Suppose we begin with a segment of the economy where the direct hand of government is least visible—that of automobile credit, and of installment and consumer credit generally. In the latest figures, consumer credit has reached \$32 billion, with installment credit at \$25 billion, and with more than \$12 billion in automobile credit alone. All these are the highest sums on record. But those close to the situation are even more troubled by the quality than by the quantity of this credit. The National Automobile Dealers Association is warning its members that “crazy credit terms” are a

threat to the industry: “To sign a contract which results in a buyer owing more than his car is worth—at any time during the terms of the contract—is business suicide.”

All this may seem at first glance to be solely the fault of dealers, banks, and finance companies. But if the *general* supply of credit had not been kept artificially cheap and plentiful by government policy, these excesses of installment credit could not have developed. It was Federal Reserve policy that reduced the rediscount rate from 2 to 1½ percent in 1954; the rate was not restored to 2 percent until this month (Aug. 4). As a result of this low discount rate, and of other government policies, the country’s money supply (as measured by total bank deposits and currency outside of banks) increased \$9 billion between May of last year and May of this year. This increased money and credit financed the boom.

But this is not the only way in which the government has brought about an inflationary credit boom. It now has \$7 billion of the taxpayers’ money invested in the propping up of farm prices by its holdings of “surplus” crops. But most fantastic of all has been the policy in regard to housing.

Until a few weeks ago a veteran, under the government’s guaranteed mortgage plan, could “buy” a \$10,000 home without putting up a nickel. He had 30 years in which to pay the mortgage off. The Veterans Administration and the Federal Housing Administration have now cut the payoff period down to 25 years. The VA will now require a down payment of 2 percent instead of none; the FHA, a down payment of 7 percent instead of 5. Even this mild change has led to cries of anguish from builders who had been profiting under the old rules. But what sort of government policy is it that encourages families to assume debts beyond their resources; that has piled up an \$80 billion debt by home buyers; that in a construction boom already at an annual record, when current rates of home building are nearly twice as high as the estimated rate of household formations, whips it up still further by unsound credit? And even on top of this, demands 35,000 subsidized government-housing units a year?

If careful students of the business cycle have at last discovered any one thing it is that the best way to prevent a slump is to prevent the preceding unsound boom. Arthur F. Burns, chairman of the Council of Economic Advisers, has himself expressed such a view (see my *Newsweek* article of June 29, 1953). This wisdom has not been reflected in recent governmental credit policies. ❁

## 'Beyond' Capitalism?

September 5, 1955

In *Newsweek* of Oct. 25, 1954, I reviewed a book on America written by the Swiss economist, Prof. William E. Rappard, published in Paris, and expressed the hope that it would be translated into English and published here. I am glad to announce that this has now been done. The translated work appears under the title *The Secret of American Prosperity* (Greenberg, \$3.50). Its publication date is Sept. 8. The occasion provides an opportunity to review another book published in French, but with somewhat different implications. On June 26 last I was startled to read a Paris dispatch to *The New York Times* which began: "Capitalism in the United States is a thing of the past, according to an official document circulated in France by the United States Information Service." I sent for the document, which runs to 80 pages.

A good deal of what the book has to say is shrewd and sensible. In fact, most of the best things it has to say were already said in Professor Rappard's book. Rappard, for example, selects four main elements as explaining the economic superiority of the United States: (1) Mass production; (2) the application of science to production; (3) a passion for productivity; (4) the spirit of competition. The document published by the U.S. Information Service also explains American productivity under these four heads, sometimes in strikingly similar words, though if any credit is given to Professor Rappard my eye completely missed it.

Yet the USIS document remains especially disturbing because of its repudiation of "capitalism." It reveals no understanding or recognition of the capitalistic basis of American productivity. The book bears the title *The American Economy* (*L'Economie Américaine*), and the subtitle *Beyond 'Capitalism'* (*Au-delà du 'capitalisme'*). The theme implied by this subtitle is carried out in the text: "America [my translation] has been a capitalistic state. . . . It has had its miserable proletariat and its injustices." Again: "American life is no longer the life of a society essentially capitalistic. It is now approaching standards of justice and equality," etc. What this book does, in brief, is to use the word "capitalism" pretty much in the same smear sense as the Marxian socialists who invented the word. It follows that, when general prosperity and productivity are to be explained, they cannot be explained on the assumption that America still has "capitalism." It must have been superseded by something else. What this something else is, the USIS book never quite makes clear.

Nowhere, in fact, does this book give explicit credit for American progress in the capitalistic system. It explains how much the American economy owes to the beneficent interventionism of government: The TVA, farm-price support, FHA mortgage guarantees, minimum-wage laws, social security. Much is said of mass production, technical research, the spirit of competition, the raising of wages, the lowering of prices, the increase of purchasing power. But nothing is said about the basic capitalistic principles of which all these are consequences rather than causes. There is no emphasis on private property. Much is said about the willingness of American corporations to build new plants and to install ever new and more efficient machines. But it is not pointed out that for them to do this they must have acquired past profits to invest; they must be allowed profits, and they must have confidence that they will be free to make future profits.

What America has today is *capitalism*, at its highest development to date. If it is more productive than the capitalism of yesterday, it is primarily because the capitalism of yesterday made this possible.

This book of the USIS, in brief, is merely another illustration of the fact that while socialist and Communist governments have no hesitation in denouncing capitalism, the governments of capitalistic countries are afraid to defend capitalism. We fatuously deny that we have it, and spend millions of our taxpayers' dollars in order to give the case away. ☸

## Unstable Paradise

September 12, 1955

The unparalleled boom we are now enjoying is not confined to this country, but largely shared by Europe. Recent dispatches from there have reported that virtually every major industrial region is operating under conditions of "full employment."

This is no mere coincidence. When major countries operated under an international gold standard, and when trade among them was comparatively free, it was only natural that prosperity (or depression) in one area should spread to others. And though the world today is much less of an economic unit than it used to be, though each country tends to pursue its own paper-money policy and to erect all sorts of barriers to imports, this mutual influence still holds to some extent.

But what has mainly caused the widespread full employment of today is the political popularity of "full-employment policies" within every nation. These are also supported by the intellectual prestige of Keynesian

doctrines. And in any case, who can argue against “full employment”?

Yet there is a fly in the ointment. Hurricane warnings trouble this paradise. What threatens to cause hurricanes is not the end-result sought. Full employment (when the phrase is appropriately defined) is both a desirable end in itself and a necessary means for the achievement of such wider ends as maximum production and maximum consumer welfare. The real trouble lies in the means being used to bring full employment about.

The most desirable way to bring about enduring “full employment” is to provide a stable currency, and to keep prices, wages, and interest rates free, competitive, and flexible, so that a workable dynamic relationship can be constantly maintained between one price and another, one wage and another, between prices and costs, prices and wages, payrolls and profits.

But this is not what the leading nations of the Western world are doing today. They have achieved their present full employment by monetary inflation—that is, by steadily increasing their supply of money and credit. The United States money supply (bank deposits plus currency outside of banks) increased from \$204 billion in May a year ago to \$213 billion in May of this year. In a roughly corresponding period, in leading European countries, we find a money increase in England from 5.32 to 5.43 billion pounds sterling; in Germany from 23.4 to 26.1 billion marks; in Italy from 3,523 to 3,956 billion lire; in Belgium from 180 to 190 billion francs, and in France from 4,664 to 5,312 billion francs.

A defense which will doubtless be offered in at least several cases is that this increased supply of money was not created by deficit financing but by an effort of the banks to “meet the legitimate demands of business.” This sort of defense overlooks the fact that both in America and in most European countries money rates have been kept artificially low through government policy. It is these low interest rates that have encouraged dubious borrowing and thereby increased the money and credit supply.

Inflation produces its alleged miracles by temporarily increasing volume of sales and profit margins. But the full employment that follows from this always produces union demands for increased wage rates. Once these increased wage rates are granted, they threaten foreign or domestic sales through increased prices, or threaten to wipe out profit margins. This is the fear that haunts European governments today. The Keynesian “cure” is to inflate the currency a little more, in order to restore profit margins and consumer purchasing power.

This is the inflationary spiral, which may so easily get out of hand.

In brief, the blessings of full employment obtained through inflation are unstable and dangerous. The government that embarks upon such a policy is like a juggler forced to keep more and more china plates in the air and dreading a single miss. That is why interest rates are being raised everywhere, why there are fears of a new round of inflation, and why the world is now likely to see increasingly serious discussion of a return to more orthodox measures. ⚙

## What Is Progress?

September 19, 1955

At the adjournment of the last session of Congress, the President at his press conference made some remarks that require more serious examination than they have yet received. It may seem a late date to hark back to something that Mr. Eisenhower said on Aug. 4, but his words on that occasion threw a great deal of light on his philosophy of government, and on the policies we may expect him to follow while he remains in office. He remarked at that time that he had a “little list” of “needed” legislation, of which at least four items were still “absolutely vital to our future. . . . They are school construction for our children, the health program, the highway program, and the water resources.”

Now of course schools and health and highways and water are vital to our future. But this is not exactly what Mr. Eisenhower meant. He meant that it was “absolutely vital” for the *Federal government* to subsidize local school construction; for the *Federal government* to reinsure private health insurance; for the *Federal government* to provide enormous grants for highway construction; etc. It is not only not vital for the Federal government to do these things; it is dangerous politically and economically. The notion that the Federal government must take over such functions goes directly counter to the principles of our Constitution and to our ideals of local self-government.

Other remarks of the President at this conference implied a broader philosophy no less disturbing. Mr. Eisenhower pointed to the “almost unprecedented prosperity” in America today, and implied that this boom must be kept whirling at its present peak, or beyond, with no slackening whatever. “If we are going to keep that kind of thing moving,” he said, “it means that *there must forever be action*, not only in the economic and industrial field on the part of the individuals in our system of free enterprise, *but government as*



*well.*" (My italics.) There are two implications in these statements.

The first is that it is the function and duty of the Federal government to keep a boom constantly whipped up to a peak by unceasing government policies of spending, subsidies, and credit inflation. A widely held economic theory today is that it is not the duty and function of the government to balance its budget annually, but rather to "compensate" for the oscillations in the private economy—building a budget surplus, taxing heavily, and contracting credit in boom times, but running a deficit, reducing taxes, and expanding credit in times of depression or unemployment. Even if we grant (I don't) that this theory is sound from an economic point of view, it should now be obvious to everyone that it is politically unworkable. For the government in power always acts as if it were "fighting a depression." It never admits that it is in an inflationary boom which it is its duty to dampen down. This is now being proved afresh by the present Administration. It has been proved over and over again here and in Europe, since the end the last world war.

The second implication of the President's statements is even wider. It is that no matter what level of prosperity or welfare we reach, the government must go on and on—"there must forever be action"—and always in the same direction—i.e., the direction of the New Deal, of the paternalistic welfare state, the direction of more and more government spending for alleged "vital" purposes.

"We must make progress," summed up Mr. Eisenhower. But what is progress? Is it for the government to spend more this year than last year? To subsidize more and more pressure groups? To have a bigger deficit this year than last? The glaring truth which all these theories overlook is that the government cannot give a dollar to one man unless it takes it from another. It cannot give a nickel to Peter without taking it from Paul—the man who has earned it. And this process must reduce the productive incentives both of Peter and of Paul. It does not meet more needs but fewer. It leaves us not richer, but poorer, than we would otherwise have been. ❁

## Balance It Now

September 26, 1955

The budget has become a political football. The leaders of both parties, with a few honorable exceptions, are competing with each other in demagoguery rather than responsibility.

On Aug. 25 George M. Humphrey, Secretary of the Treasury, announced that the deficit for the current fiscal year (ending next June 30), which was estimated in January at \$2.4 billion, is now estimated at only \$1.7 billion. He went farther. "Barring some unforeseen development we think that we should, and that we can, balance the budget this year."

This made cheerful headlines. But a closer look was less reassuring. The reason for the reduction in the estimated deficit lay wholly in an increased estimate of Federal receipts since January, owing to the present boom. Treasury receipts are estimated at \$2.1 billion more than in January. But expenditures also are now estimated at \$1.4 billion more than in January.

It is disturbing to notice the items on which spending estimates are now increased. The largest increase is \$1.1 billion for farm-price support. Another increase is \$272 million for foreign economic aid. Here are two items on which drastic spending cuts, rather than increases, would be more justified. Even more disturbing are comparisons of proposed expenditures for non-defense items as a whole. In the current fiscal year the Treasury will pay out \$25.1 billion for nondefense items, compared with \$22 billion forecast seven months ago, and with only \$21.3 billion actually spent in the year ended June 30, 1954. This year's budget would already be indicating a substantial surplus instead of a deficit, in brief, had nondefense spending been held to the fiscal 1954 level.

The Democratic majority has not come forward with any specific suggestion as to where the President might cut nondefense spending. Adlai Stevenson, in fact, indicates that he doesn't think enough of the taxpayers' money is being thrown away in piling up farm surpluses. But when it was given out on Sept. 6 that the Defense Department was aiming at an expenditure of only \$33 billion for the current fiscal year instead of the \$34 billion in its estimate two weeks earlier, one Democratic senator immediately shouted that this was "putting dollars ahead of defense," and another was sure it would mean "a sacrifice of national security." Obviously neither had any means of knowing whether his charge was true. To say that a budget made up of hundreds of thousands of heterogeneous items is "safe" at \$34 billion and "dangerous" at \$33 billion is to talk obvious claptrap.

Harry S. Truman (the man who advocated a \$9.9 billion deficit for the fiscal year 1954) rose to new heights of comic inconsistency. He declared that this is no time to reduce taxes because Mr. Eisenhower must balance the budget! A few days later he called the



proposed military expenditure cut a “politically inspired plan to balance the budget!”

Secretary Humphrey rightly declared: “If there ever is a time when our budget should be balanced, it is now.” But he added that once a balanced budget was achieved, “still further progress would justify lower tax rates.” Immediately, Democratic Senator George and Republican Senator Millikin said they would favor tax reductions next year even if government spending and income were not completely balanced.

Amid this bipartisan competition in demagoguery one or two voices have been courageously raised on both the Republican and Democratic sides in favor of economic sense. Congressman Daniel A. Reed, chief Republican spokesman on taxes in the House, has branded talk of substantial tax relief next year as “premature.” Clear, firm, and emphatic, as usual, has been Sen. Harry F. Byrd: “It would be foolhardy to balance the budget and then unbalance it by a premature reduction in taxes. I strongly favor tax reduction made possible by retrenchment in spending.”

But if we judge by the level of political humbug to which both parties have now descended, these isolated voices of sense and courage do not seem likely to prevail. ☼

## A Fallacy Exposed Again

October 3, 1955

In his column in *The New York Times* of Sept. 8, Arthur Krock presented one “obviously important reason why the Secretary of the Treasury and other Presidential advisers believe that the budget can soon be balanced . . . without depressing the buoyant national economy.”

This reason is that private spending in this country, in Krock’s words, “has been steadily replacing . . . and topping, the billions cut from the budget by the Eisenhower Administration.” This conclusion is supported by a table (at the bottom of this column) of comparative official statistics for the second quarters of 1953, 1954, and 1955. The figures are expressed in billions of dollars at seasonally adjusted annual rates. They show that while government spending was running at an annual rate of \$3.4 billion less in the 1955 quarter than in 1954, and \$15.8 billion less than in the corresponding 1953 quarter, nongovernment activity was running in the second quarter of 1955 at a rate \$30.6 billion higher than in the same period of 1954 and \$31.3 billion higher than in 1953.

Krock calls this “one of the most remarkable aspects of economic development in the United States for years. For,” he correctly says, “the view has been, and still is, strongly held that shrinkages in the Federal budget must in time, and at a certain point, start the economy downward.”

Yet there is really nothing astonishing about this development except to those who have so tenaciously held this completely false view. I hope I may be forgiven if I cite the new comparisons with special satisfaction. In my *Newsweek* column of Jan. 12, 1953, I remarked: “What troubles me about the current crop of forecasts for 1953 [including one by the Department of Commerce] is that most of them rest on [the] fallacious . . . assumption that the future of business activity at this time depends primarily on the government’s defense-spending program. If that rises, we are told, business activity and prices will rise . . . but if it declines, there’s no telling how much business will deteriorate.”

This assumption, I pointed out, would lead to the absurd conclusion “that the more resources we are forced to devote to making guns and tanks and shells, instead of consumer goods, the richer we become. . . . The fallacy consists in looking only at the government’s defense payments and forgetting that the money for these comes ultimately from taxes. If defense payments suddenly dropped from the present \$50 billion a year to only \$10 billion, taxes could also be cut by \$40 billion. Then the taxpayers . . . would have \$40 billion more to spend than they had before, to make up for the \$40 billion drop in government spending. . . . There is no reason to suppose that the overall volume of output or activity would decline.”

I went on to show that the whole theory that defense spending is necessary for prosperity “got a crushing refutation at the end of the second world war. Immediately after Japan surrendered in August 1945 there was a sweeping cancellation of war contracts. Government economists predicted that unemployment would reach 8 million by the following spring. Nothing of the sort happened.”

Yet this fallacy was still raging so strongly a year and a half later that in *Newsweek* of July 19, 1954, I pointed out again: “In the fiscal year 1944 the Federal government spent \$95 billion; in the fiscal year 1947 it spent \$39 billion. Here was a drop in the annual Federal spending rate in this three-year period of \$56 billion. Yet, far from there being a recession in this three-year period, there was a substantial increase in employment, wages, and prices.”

	1953	1954	1955
Gross National Product	369.3	357.6	384.8
Federal purchases of goods and services	61.0	48.6	45.2
All other expenditures	308.3	309.0	339.6

A particularly hardy myth has once more got a crushing factual exposure. ☸

## What Kind of Tax Cuts?

October 10, 1955

Reports have been leaking out of Washington that the Republicans plan to vote for a cut in taxes whether or not the budget is balanced. One report is that they are even seriously considering an increase of \$100 in the personal income tax exemption.

Such reports, if true, would be profoundly discouraging. There should be no tax cut at all unless and until the budget is not only balanced but shows a prospective surplus from which the tax cut could be taken. We are now facing the 23rd deficit in the last 26 years. If we cannot balance the budget at the very peak of prosperity, how can we ever hope to balance it at all? A planned deficit is a planned inflation. Inflation is the most unjust of all taxes.

If a tax cut is now possible, it certainly should not be made by increasing personal income tax exemptions by \$100. It is impossible to believe that the President himself ever seriously considered this. It is precisely the proposal the Democrats brought forward in the spring of 1954. At that time Mr. Eisenhower made a courageous and statesmanlike TV talk exposing the transparent demagogic character of the proposal. It would remove about 5 million people from the necessity of paying any income tax at all. It would thereby foster in them the dangerous illusion that "the other fellow" was paying the bill. And it would cost the government some \$2.5 billion in annual revenue. This is not much different from the proposal made by the Democrats this spring for a \$20 cut in everybody's income tax. Mr. Eisenhower correctly called that scheme "the height of fiscal irresponsibility."

If any tax cuts are possible now, they should be made first of all at two points where any "practical" politician would consider it suicidal to suggest them. There should be a cut in the corporation income tax rate and a cut in the confiscatory rates on the highest personal income brackets.

Congress actually voted several years ago to reduce the corporate income tax rate from 52 percent to 47 percent. But it has been voting to postpone this cut from year to year; and the reduction is now being treated as out of the question. Yet a cut in the corporate income tax from 52 percent to 50 percent would mean a cut in revenues of only about \$85 million.

If the top rate on the personal income tax were reduced from its present level of 91 percent to 80 percent next year, and then successively to 70, 60, and 50 percent, the cut would probably not reduce revenues at all. It would in fact, probably increase them. I have pointed out in preceding articles (March 29, 1954) that "of the \$31 billion that the personal income tax yields, only about \$1 billion comes from the rates above 50 percent." All we have done by these confiscatory rates on the higher incomes has been to erode the incentives to produce higher incomes.

The reason why neither of these two tax reductions is now discussed is purely political. The Democrats started up the propagandistic howl that the Eisenhower Administration is a government "for big business" and "for the rich." Administration officials seem to be in deadly fear of this charge. But they are likely to do best politically as well as economically if they act now with statesmanship, courage, and sense.

It was recently calculated that American industry has invested about \$12,500 for every job it has created. This tremendous investment putting incomparably more and better machines and equipment in the hands of the American worker than in the hands of any other worker, is the main if not the sole reason why the American worker's productivity is greater than that of any other worker in the world, and why his wages are correspondingly greater. If industry is drained of these investment funds American supremacy will be lost. If the incentives to earning, saving, an investing wealth are removed, the very source of productivity and high wages will be removed. By all odds the best way to "help the little fellow" is to encourage the profits, savings and investments that make his job and his income possible. ☸

## Delegation of Power

October 17, 1955

"In case of the removal of the President from office, or of his death, resignation, or inability to discharge the powers and duties of the said office, the same shall devolve on the Vice President, and the Congress may by law provide for the case of removal, death, resignation or inability, both of the President and Vice President,

declaring what officer shall then act as President, and such officer shall act accordingly until the disability be removed or a President shall be elected.” Thus reads the Constitution. Death and resignation are matters beyond dispute; but “inability” is more often than not a question of opinion. Does it refer to physical inability? Or (as some suggest), merely to mental inability?

And who is to decide that the inability exists? The Constitution does not say explicitly who is to make that decision, but by implication it puts it in the hands of Congress. Congress, in any case, is explicitly authorized to pass laws governing the subject. And Congress may also, by explicit direction, provide for purely temporary replacement of the President “until the disability be removed.”

Yet from the beginning of our history Congress has neglected its clear duty in this matter, in spite of the sharpest reminders. President Garfield was shot on July 2, 1881, and lived on for 80 days. During his illness he performed only one official act—the signing of an extradition paper. At the first opportunity one would have thought that Congress would have made legal provision to prevent a repetition of such paralysis in government. It did nothing. President Wilson collapsed on Sept. 25, 1919, and was not able to attend a Cabinet meeting until the following April. Once more government had been paralyzed. Once more Congress ignored a warning.

This is not the moment to attempt to make any Constitutional change concerning this problem; but it is clearly the time to make legal provision for the present emergency. A person who has suffered a coronary thrombosis needs, above all, two things—complete physical and mental rest (and this is usually to be counted in months rather than weeks), and complete relief from anxiety. The great danger of the present situation is that Mr. Eisenhower will be pushed into attempting too much too soon, and risking a setback. Many Republicans are trying to minimize his illness. Some even foolishly talked of his resuming the reins of government in a few weeks. And a few extreme Democrats call it presumptuous for Vice President Nixon or Sherman Adams to carry on routine functions. Yet it is of the utmost importance not only that Mr. Eisenhower should not be prevailed upon to do too much too soon, but that he should not be made to suffer anxiety because of his enforced inactivity.

The simplest and safest way to insure the President his needed rest, and at the same time to avoid the many dangers of a temporarily headless government, is to get Mr. Eisenhower’s consent to call a special session of Congress and to submit to it, a simple bill allowing

the President to delegate as much of his powers and duties as he saw fit to the Vice President, and also to withdraw this delegation at any time he thought proper. This would give Mr. Eisenhower the choice of acting in whatever way he thought wisest. It would give him the assurance that the Vice President could make whatever decisions or take whatever actions were necessary until the President’s full recovery. And it would insure that these actions would be legal.

The fact that there is no government emergency at the moment of writing is not a reason for doing nothing. On the contrary, it provides the very opportunity necessary for Congress to provide the discretionary powers of delegation which could enable our government to make whatever quick decision or set of decisions might be necessary in the event of an unexpected emergency in foreign relations or in domestic economic policy without strain on the President or further risk to his health. This is the course indicated by forethought and common prudence. ❁

## The Farm ‘Parity’ Fraud

October 24, 1955

The myth of a farm “crisis” has been built up in recent months by the farm bloc in Congress. Farm income is of course below the Korean-war boom level. But nothing justifies the label of a “crisis.” And apart from this, the “remedies” proposed are utterly devoid of economic sense.

The whole notion of a price “parity” that ought to be perpetually maintained between farm and nonfarm prices is absurd. So is the whole idea that any group of producers is perpetually entitled to some fixed “fair share” of the national income. If there were any merit in such a notion, it ought to be universally applied. If farm prices are to bear the same relationship to nonfarm prices that they bore in the extremely favorable period from 1910 to 1914 (now more than 40 years past), then the price of everything ought to bear that 1910–14 relationship to the price of everything else, and the public Treasury ought to be used to maintain this relationship. Nobody has so far been brazen enough to propose anything so preposterous. Everyone knows that the supply and demand and conditions of cost of production for every commodity change every year. The market, as well as “fairness,” must reflect such changes.

The parity nonsense is not applied consistently even to farm prices. It is applied to half a dozen so-called “basic” commodities—wheat, cotton, corn, tobacco, rice, and peanuts—and about twenty “nonbasic”



commodities. Taken all together the value of price-supported items is less than half of total farm cash income. The farmers who raise the other commodities must depend on themselves. But the price supports distort farm-price interrelationships and often increase the pressure on farmers raising unsupported commodities. Cattle raisers, for example, are hurt by the artificially high prices they must pay for feed.

The methods of providing price supports are also inconsistent, one-sided, and about as mischievous as could be imagined. The government makes "loans" to farmers for some crops at the high price level that Congress prescribes. If the price rises even above that level the farmer can sell his crop and make the extra profit. If it falls below that level he can let the taxpayer take the loss.

One result of this system has been the piling up of huge artificially created farm surpluses in warehouses. The government now holds \$7 billion worth of farm products in storage. More and more storage space, expensive and but for this foolish plan entirely needless, is being built to hold these mounting surpluses. Even a large number of second-world-war freight ships are now being used to hold millions of bushels of grain.

These surpluses hang over the market, and exercise a depressing effect on market prices. To maintain our artificial farm-price levels we impose import quotas on foreign farm commodities. Worse, we try to dump our government-created surpluses on foreign markets. We thereby create an immense amount of ill will abroad and make a mockery of all our pious advice that the world should lower international trade barriers. The American city worker pays these artificial farm prices both as a taxpayer and as a consumer who is charged more for his foodstuffs in the market.

It would be easy to suggest a less preposterous "farm policy" than the present one. The real gain from the Benson program is not that it provides "flexible" price supports but that it makes possible *lower* price supports. But the main problem is to get the government altogether out of this fantastic fiasco. It is the program itself that is today creating most of the farmer's problems. Without it he would not have been encouraged to raise unsalable crops, but could have adjusted himself to actual demand as every other producer must do.

On the economic side it would not be too difficult for the government to get out from under the present program. It could announce a halt in further price support within a year. But what is primarily needed—and what seems to be altogether lacking—is the political courage in Washington within either party to talk sense to the American people on this issue. ☼

## Farm Fiasco: A Way Out

October 31, 1955

The so-called farm "crisis," as I pointed out here last week, is not primarily economic but political. It exists chiefly in Washington. And politicians, instead of considering how to extricate the government from its price-support fiasco, talk of even bigger and more harmful subsidies.

It is true that certain farm groups, such as hog raisers, today face special difficulties. But realized gross farm income was running in the first half of this year at the annual rate of \$33.7 billion, compared with an average annual income of \$33.8 billion in the preceding nine years (which include the Korean-war boom years). This hardly indicates a crisis.

Regardless of such comparisons, the whole farm subsidy program is wrong in principle. In the long run it must work more harm than good to the farmers themselves. The chief problem today is to extricate the government from the present fiasco. Let us look at some ways in which this might be done.

1—The whole notion of a price "parity" that ought to be perpetually maintained between farm and non-farm prices is ridiculous. But the parity formula is at least being made a little less preposterous than it has been. Instead of taking the 40-year-old period from 1910 to 1914 as the basis, we are now transferring to a rolling average of the relationships between prices paid and prices received by farmers for the ten years preceding each crop year.

2—A more important step (if we assume that it is politically impossible to get rid of the price-support program altogether) would be to lower the price-support level, not to a point where it would assure the farmer a so-called "fair" income, but to the point where it would protect him against out-of-pocket loss. The reason for this should be obvious. Wherever a surplus already exists it is fantastic for the government to offer a support price to encourage the farmer to grow a still greater surplus. Rather the effort must be to prevent the farmers from repeating the collective error that led to the problem. Government estimates indicate that farm production expenses are usually about two thirds of realized gross farm income. On this basis the government support level should not be 90 percent of "parity," or even 75, but only about 67 percent.

3—Even assuming that some price-support program is to continue, there is no justification for offering the farmer or any other producer a one-way speculation against the taxpayer in which the taxpayer takes all the losses and the producer only the profits. Instead of



its present "nonrecourse loans," the government should buy outright, and be free to dispose as it wishes of what it holds.

4—There is a possible way in which the government could get out from under its present enormous holdings of crop surpluses, and in the process perhaps solve several problems at once. This would be to offer to sell its holdings, at a price slightly below estimated cost of production, *back to the farmers themselves*. Each farmer might be allowed to buy an amount proportionate to that of his own production of that commodity in the preceding year. The government would doubtless take a big loss on this—but not as big as it ultimately would by continuing its present program. The farmers who bought the commodities would be free to sell them in the market at the best price they could get.

Under such an arrangement a farmer could have a good part of one year's crop, say, without the usual work and risks of raising it. He would almost certainly be able to sell it at a profit. Few farmers, knowing in advance that this carry-over would be thrown on the market, would plant the same crop for the new year. (Any such government plan should of course be announced a month or so before the normal planting season.) In this way most of the surpluses now held by the government could be worked off in a short period.

The farm price-support program has been growing like a cancer. Only a drastic surgical operation seems likely to curb it now. ❁

## A Flood of Debt

November 7, 1955

The current prosperity has been mounting to ever higher peaks. In the third quarter of this year the total amount of goods and services produced in the U.S. (the "gross national product," affectionately known as GNP) rose to an annual rate of \$392 billion, the highest on record.

Official estimates also intimate that the increase in the gross national product in the third quarter was founded on consumer buying, itself at the annual rate of more than \$256 billion, highest in history. But how stable is this economic paradise? For how many quarterly periods can we continue to build up new records? In *Newsweek* of Aug. 29, in a column entitled "A Flood of Credit," I pointed out the large extent to which the current boom rested on credit expansion. An article on the same theme appears by Jules Backman in the October issue of a little magazine called *Challenge*, published by New York University. Though many of the statistical comparisons that Professor Backman makes

cover the same ground as those in my Aug. 29 column, his own article adds some additional and very striking comparisons.

The boom in housing, in automobiles, and other durable goods has been financed to a large extent by personal debt. By the end of June 1955, the volume of automobile credit outstanding, at \$12.5 billions, was 23 percent higher than twelve months earlier. Total consumer credit, at \$32.5 billion, increased 13 percent during the same period. The August total of \$33.6 billion compared with only \$5.7 billion at the end of 1945.

Again, under the imprudent mortgage guarantees of the Federal Housing Administration and the Veterans Administration, mortgage debt on one- to four-family houses climbed from \$66.3 billion at the end of 1953 to an estimated \$82 billion in June 1955. Together, consumer credit and mortgage debt have increased from about \$24 billion at the end of 1945 to about \$110 billion, while total private debt has risen from \$140 billion to \$360 billion.

Are we too deep in debt? Professor Backman makes some judicious answers. He points out, quite rightly, that any exact quantitative measurement of the safe limit to personal debt is impossible. But he also points out that the current ratio of consumer debt to total personal income after taxes is the highest on record. To put it another way, the rate of increase in consumer credit has been greater than the rate of increase in consumer income.

And he makes a sensible observation that emphasizes the dangers in this situation. The safeness of consumer credit is not measured solely by the ability of the borrowers to carry the interest burden, or even to repay the principal. It is measured also by the impact of expanding debt on the future level of general business activity. When consumers spend beyond their incomes, they obviously stimulate the economy to the extent of their borrowing. A family earning \$100 a week, for example may spend much more as it refurnishes a home, buys a car, a television set, or a refrigerator. But at some future date, the family will have to spend less than its current income if it is to repay the loan. If the total volume of consumer credit merely stops growing, part of the stimulus to the economy is lost. When repayments exceed new debt, recessionary tendencies may develop. Yet periods of borrowing must be followed by periods of repayment.

Considerations like these perhaps explain why our Federal monetary authorities are fearful of a further rise in credit, but fearful also of bringing the rise to a halt. Some officials discourage the idea of a further advance in the Federal Reserve discount rate even above 2½

percent because “it might rock the boat.” But may it not eventually rock the boat still more to allow credit expansion to continue? The country’s money supply (measured by bank deposits and currency) increased \$10 billion at the end of July compared with the same date a year ago, largely as a result of a \$9.4 billion increase in commercial bank loans in the same period. How long can we keep up this rate of money and credit inflation? ❁

## Stevenson’s Farm Claptrap

November 14, 1955

Developments of the last few weeks reveal once more that no matter how high or harmful a subsidy may be, it creates vested economic and political interests that demand not merely its continuance but its increase.

Even Secretary Benson, who has been urging moderation and sense, was forced by political clamor to announce that \$85 million of the taxpayers’ money would be thrown into buying pork and lard in an effort to halt the decline in hog prices. True, hog prices are comparatively low. But it never occurs to those who are bawling for government subsidies to ask *why* hog prices are low, and what the consequences may be if the government boosts them. The truth is simply that hog prices have been falling because the demand for pork has been declining while the supply of pork has been increasing. Profitable hog prices will not be restored until the supply of hogs is brought into workable relationship with reduced demand. But any government support which falsifies prices will encourage hog raisers to continue in the same course that led to their existing troubles. It will prolong and eventually increase these troubles.

In the same way, it is the 90-per-cent-of-parity support for “basic commodities” that led to the huge crop surpluses which have exhausted storage capacity, misdirected farm production, forced our farm products out of world markets, led to our import quotas and export dumping schemes, and thrown a heavy burden on the city buyer of foodstuffs and on the taxpayers.

The appalling consequences of this policy should at last be clear even to a schoolboy. Yet that great statesman and intellectual, Adlai Stevenson, has joined the clamor for an immediate return to rigid farm prices at 90 percent of parity. His argument for this is incredibly naïve. “Our objective for agriculture,” he declared, “is equality with the other parts of our economy.” What does he mean by “equality”? Does he mean that everybody, whether farmer, factory worker, or film star, should have the same income as everybody else? He

cannot mean anything like this—which shows how loosely he uses words.

He tries to explain what he does mean: “Our yardstick for measuring this equality is parity—a formula for fairness based on relating what a farmer gets for what he sells to what he must pay for what he buys. And 90 percent of what is fair is certainly not unfair or too high.” Here is a priceless specimen of begging the question. If parity is “fair,” then it certainly cannot be unfair. In fact, if parity is “fair,” only 90 percent of it must be unfair. Why is Stevenson so niggardly? Why not 100 percent parity for 100 percent fairness?

Of course what “parity” really means is that a certain past relationship between prices that existed from 1910 to 1914, or in the ten past years, is to be perpetually preserved, at the expense of the taxpayer and consumer, no matter how drastic the changes have been in supply and demand or in the conditions and costs of production. If Stevenson knows anything about this matter at all, he must know that as a result of trying to maintain 90 percent parity the government is now holding \$7 billion in unsalable farm surpluses. It would take nearly a year to use up the American cotton already in storage. It would take at least two years to consume the record volume of American wheat already in storage. When such surpluses already exist, it is preposterous to support prices that encourage the farmer to grow still greater and more unmanageable surpluses.

What Stevenson is really saying is that he desperately wants the Democratic nomination; and that he thinks the farmers’ vote can be bought by this further bribe at the expense of the taxpayers and of city workers who must pay it through higher food bills. If Stevenson does not realize the economic consequences of what he is proposing, he is surely not fit for the high office to which he aspires. If he does realize these consequences, then we can only conclude that, like Harry Hopkins, he cynically thinks the American people are “too damn dumb to understand.” ❁

## Revolt against Spending

November 21, 1955

Immediately before last year’s Congressional elections, I pointed out in this column (Nov. 1) that the “middle-of-the-road” and semi-New Deal policies being pursued by the present Administration would probably be the main cause of a Republican Congressional defeat if it occurred. Following those elections (Nov. 22), I remarked that the real danger of the Republican defeat that had just occurred was that “Administration

Republicans . . . may interpret the result as a repudiation of President Eisenhower's more conservative policies and a public demand for return to New Dealism—to big government, big spending, inflation, and subservience to labor-union bosses." Unfortunately, this interpretation did in the main prevail. In this year's local elections we have had further Democratic gains. And once more it is widely argued that this is because the Eisenhower Administration did not go sufficiently left.

A more plausible interpretation is the very opposite—that the Democratic voters, as usual, voted for Democrats, but that a substantial percentage of conservative Republicans, disheartened by the abandonment of traditional conservative Republican policies on the part of the Administration, simply stayed home—as they did in the Truman-Dewey election of 1948 and as they did last year.

It might be difficult to prove this interpretation statistically if we did not happen to have direct evidence that whatever caused the election of more Democrats and fewer Republicans, it was not a drift of the electorate toward the left. This direct evidence shows, on the contrary, a return toward conservatism. It shows a revolt, above all, against the constant increase of government spending.

The most dramatic example of this was in Ohio, where, in the face of tremendous CIO propaganda, the voters overwhelmingly rejected a proposal to increase the state's unemployment-compensation benefits from a maximum of \$33 to \$50 a week, to extend the length of time a person can receive benefits from 26 to 39 weeks, and to permit the payment of state unemployment benefits to people drawing out-of-work pay from private industry. The votes of many factory workers, including rank-and-file CIO members themselves, must have been against this proposal to bring about such a defeat.

Only slightly less dramatic were the results in New York State. Here the voters heavily rejected a proposed constitutional amendment to authorize a \$750 million bond issue for highway construction. They defeated a proposed amendment authorizing local governments to borrow in excess of their debt limits for sewage systems. They rejected a proposition to authorize the lending of \$50 million in state housing funds for "middle income" housing. They very nearly defeated the proposal to increase annual subsidies for low-rent housing from \$25 million to \$34 million. In New York, such housing subsidies have hitherto been approved by overwhelming majorities.

Over the country as a whole, the balloting resulted in the defeat of 75 percent of the bond issues proposed to finance road building and other projects. This

reversed the pattern of recent years in which the voters have ratified an average of 85 percent of the bond issues submitted to them.

Let us hope that the lesson will not be lost in Washington. If people in our richest states have finally decided that they cannot afford to keep on piling up debt for more roads and other improvements in their own localities, what, do you suppose, would happen if they were permitted to vote directly on the Administration's grandiose national road-building program, or on its policy of scattering subsidies totaling \$4.7 billion to dozens of foreign governments?

Next week I expect to write about the spread of the political delusion that the government can draw on a sort of Fourth Dimension to supply everybody's needs or wants without taking the corresponding dollars or goods away from anybody else. This year's elections show that the voters are less subject to this delusion than most of our politicians. ❁

## The Fourth Dimension

November 28, 1955

We are heading into our 23rd deficit in the last 26 years. In the richest and most productive year in our history, with the most onerous taxation we have known until this decade, our Federal revenue still does not equal our Federal spending. That spending now runs to about \$64 billion a year—twenty times the rate at which we were spending, say, in 1928. Yet the Administration professes helplessly that it cannot cut this down. It is not merely defense but nondefense spending that is at record levels. From a hundred directions come demands for more funds—for grandiose highway programs, Federal aid to schools, flood control, more social security, more aid to the farmers, more foreign aid. And so on and on.

It now seems futile to criticize any specific spending program. For a general delusion has taken hold of the overwhelming majority of our Washington rulers. This delusion has been given what seems to me its most appropriate name by the European economist, Wilhelm Röpke. "When demanding assistance from the state," he wrote, "people forget that it is a demand upon the other citizens merely passed on through the government, but believe they are making a demand upon a sort of Fourth Dimension which is supposed to be able to supply the wants of all and sundry to their hearts' content without any individual person having to bear the burden."



This name for the delusion is comparatively new. But the delusion itself, and correct descriptions of it, are very old. “The state,” wrote the French economist Frédéric Bastiat a century ago, “is the great fiction through which everyone attempts to live at the expense of everyone else.” And in 1842 Macaulay declared: “It is supposed by many that our rulers possess, somewhere or other, an inexhaustible storehouse of all the necessities and conveniences of life, and, from mere hardheartedness, refuse to distribute the contents of this magazine among the poor.”

This delusion thrives today as never before. Every morning our newspapers report statements that the government has not yet begun to meet our highway needs, our education needs, our farm-support needs, our hospitalization and health needs, and a thousand other “needs.” The tacit assumption is always that an increase in government spending will meet more of our total needs than were met before. But this comes from overlooking the fact that the government has not a dollar to spend on anybody that it does not take from somebody else. When a pressure group says: “We demand that the government should pay for us,” it is really saying, “we demand that other people should pay for us.”

The net result of this process is that instead of meeting more of the people’s needs than otherwise, we actually meet fewer. This is true for several reasons. In 1829, the poet Robert Southey (who was a New Dealer a century before Franklin D. Roosevelt and a Keynesian a century before Keynes) wrote that “a liberal expenditure in national [public] works” was “one of the surest means of promoting national prosperity.” Macaulay pointed out in a blistering retort some reasons why public spending is usually less needful and more wasteful than private spending.

We may add other reasons. For every additional dollar that the government spends, the taxpayers have one dollar less to spend. The situation is worse than this. Taxation erodes the incentives to produce and earn. It penalizes success, and the production of marketable products, often in order to subsidize continued production of unmarketable products. It sets up an army of taxgatherers. In the end it meets fewer real needs than before. People spend the money they themselves earn on what they themselves really want. The government spends money, not on what the rest of us want, but on what the bureaucrats think is good for us.

The delusion of an economic Fourth Dimension flourishes not merely through stupidity, but because there is now an enormous vested interest in keeping it alive. ❁

## What Is a Liberal?

December 5, 1955

We have all been long indebted to Judge Harold R. Medina, now of the U.S. Circuit Court of Appeals, for the patience, balance, and firmness with which he presided at the trial of eleven top Communists in 1949. A few weeks ago he put us further in his debt by exposing the inverted semantics into which most of us have recently fallen in our political discussion—particularly in the strange use of the word “liberal.” He regards himself as a liberal, Judge Medina declares, and he does not intend “to be frightened away because the Communists and their coadjutors have tried to appropriate the word ‘liberal’ just as they have the names of our great Presidents, Abraham Lincoln and Thomas Jefferson, by the use of Aesopian language, twisting names and personalities to suit their purpose.”

Today Socialists, fellow travelers, and Communists all call themselves liberals. As a result, as Judge Medina points out, the word has taken on “a sinister and evil connotation.” I should like to supplement his own remarks on this strange usage and its results.

Originally (as its Latin root *liber* implies) the liberal was a man who believed in freedom. The foundations of the liberal tradition were laid in England by such great figures as Milton, Locke, Hume, Burke, Adam Smith, and Mill. Politically, the liberal tradition stood for freedom for the individual, the Rule of Law, strict limitation of the powers of government, and decentralization and diffusion even of these limited powers. Economically, the liberal tradition stood for protection of private property, and for freedom of trade, of prices, of markets, and of enterprise.

But through historical accident and intellectual confusion, the word “liberal,” particularly in this country, altered and finally reversed its meaning. Today, in popular speech, a “liberal” has come to mean a person who wants constantly to expand the powers of government, and to centralize them in Washington at the expense of the states and localities. It has come to mean a person who disparages Congressional restraint on the executive power and who prefers bureaucratic discretion to the Rule of Law. Economically, it has come to mean a person who distrusts freedom of markets and freedom of enterprise; who distrusts private ownership and management and extols government ownership and management; who presses for more government “planning,” and who wants to tax and penalize success in order to subsidize failure.

Most of those in America who are called “liberals” today are, in brief, either Socialists, statist, or state



paternalists. Some leading newspapers now use the word “liberal” in their news columns, without quotation marks, to designate precisely such groups. The real liberals—those who believe in personal liberty and limited government—are usually referred to in these same news columns as “ultraconservatives” or “reactionaries.” It is not strange that state paternalists have appropriated the word “liberal” to themselves. It has had a noble meaning. When anything acquires value, it becomes worth stealing. But what is much harder to understand is why many who are libertarian in their own basic philosophy not only fail to challenge the Socialists’ and statist’s title to the word “liberal,” but have themselves begun to use it as a stigma.

This particular perversion of the word’s meaning has not occurred in most of Western Europe. In France, for example, the economists who are opposed to Socialism and state “planning,” and advocate private enterprise and free markets, now call themselves the “neo-liberals.” Their Socialist opponents admit their title to the word, and openly disparage liberalism. In Continental Europe, and even in England, the Socialists know and admit they are Socialists. But those who support Socialist principles here—the zealots for TVA, for example—furiously resent application of the term to themselves.

We need to return to first principles in our political and economic thinking. But we will never do so until after we have reexamined our political and economic vocabulary. ❀

## Cheap Money Means Inflation

December 12, 1955

The Federal Reserve Board is to be congratulated on its courage in approving an increase in the discount rate from  $2\frac{1}{4}$  to  $2\frac{1}{2}$  percent. Only a firm rein on interest rates can prevent a new spiral of inflation.

This mild action was promptly denounced, not only by Democrats in Congress but even by some bankers and businessmen. “Money was tight enough already,” complained one banker; “they’re going to make it unavailable.” If one takes comparisons for the last twenty years alone, a  $2\frac{1}{2}$  percent discount rate (the rate at which member banks can borrow from the Federal Reserve Banks) may indeed seem high. It is the fourth increase this year, and the highest discount rate since 1934.

But our generation has become so accustomed to cheap money that we have lost our perspective. In 1929 the discount rate of the Federal Reserve Bank of New

York was raised to 6 percent. It had averaged around 4 percent for the preceding decade. It had been as high as 7 percent in 1920. Nor is the present discount rate high compared with official discount rates in the rest of the world. Money has been getting tighter everywhere. A recent compilation by the London magazine *The Banker* showed that in early August the discount rate in Britain was  $4\frac{1}{2}$  percent; in Germany,  $3\frac{1}{2}$  percent; in Sweden,  $3\frac{3}{4}$  percent; in Denmark,  $5\frac{1}{2}$  percent.

In fact, if the Federal Reserve System were operating on pre-Keynesian policy it would today be charging a much higher discount rate. The late Benjamin M. Anderson, who was for many years economist of the Chase National Bank, declared in discussing the belated increase of the rediscount rate in 1920: “The Federal Reserve System should have held to the orthodox rule of keeping the rediscount rate above the rate to prime borrowing customers at the great city banks.” Today this rate is  $3\frac{1}{2}$  percent. The purpose of this “orthodox” rule was, of course, to penalize and discourage borrowing from the Federal Reserve Banks rather than to encourage the commercial banks to overlend to their own customers and then to reborrow at the Federal Reserve at an actual profit to themselves.

I do not mean to suggest that the Federal Reserve System could return overnight to this traditional rule, so long neglected. But it is time for us to recognize more clearly the direct causal connection between artificially low interest rates and inflation. Many bankers and economists talk and write today as if the sole cause of present-day inflation were a budget deficit financed by unloading government securities onto the banking system. But the inflation will be brought about, even without a budgetary deficit, whenever interest rates are kept too low in relation to the supply of and demand for real savings. This leads to overborrowing, and an increase in the money supply which pushes upwards on prices.

Some reasons why the Federal Reserve Board has now increased the discount rate are clear. The board is concerned about the upward pressures on the price level of steel, other primary metals, and building materials. Most of our economy is already operating practically at full capacity—at “full employment” of available men and resources. Any further increase in loans would tend merely to push up prices rather than lead to any further expansion in output.

Consumer spending has been rising more rapidly than consumer income. Installment credit and mortgage debt are at record levels. In September total consumer credit outstanding was at \$34.3 billion, compared with \$28.9 billion a year previous, and with \$8.4 billion

at the end of 1946. The stock market has been buoyant. Industrial companies have been announcing the most ambitious expansion programs on record. The country's money supply (total bank deposits and currency outside of banks) stood at the end of September at \$215 billion—an increase of \$7 billion over the year before. Total bank loans stood at \$78.4 billion—an increase of \$11 billion over those of September 1954.

It was time for the government to take its foot off the accelerator. ❁

## A Two-Point Farm Program

December 19, 1955

A few weeks ago Secretary of Agriculture Benson invited “everyone” in the country to send in his ideas about solutions to the farm problem. “I guarantee to you,” he said, “that those ideas will receive the most careful attention possible.”

Thus encouraged, I should like to propose a very simple farm program. I have already suggested, in *Newsweek* of Oct. 31, some ways in which the government might extricate itself from the present farm fiasco, but those proposals tried to take into account what political pressure groups might accept. If we consider merely what plan would work best *economically*, such a plan could be reduced to two points.

The first point may strike some readers as extremely novel, because it is almost nowhere being suggested. This is that Congress *stop all price guarantees and all promises of support-buying of any kind* on any crop that has not yet been planted.

Let us look at the remarkable advantages that such a plan would have. (1) It would mean immediately an enormous saving to the nation's taxpayers. (2) It would soon mean a great saving to the nation's food buyers and food consumers. (3) It would end any further accumulation of farm surpluses. Marginal farmers would stop raising crops on marginal acres. Farmers and the government would cease to hold crops off the market. We keep forgetting that the present farm surpluses are purely the creation of the price-support program itself. Farmers raise crop surpluses because they are encouraged to do so by an excessive price. The surpluses pile up because they are unsalable at the price set.

(4) With the removal of price guarantees and supports, there would no longer be any need for government acreage control or marketing quotas. Farmers do not plant crops on which they do not expect a profit. Marginal producers are no longer induced to grow crops on marginal acreage. (5) Removal of price guarantees

and supports would restore a better balance of farm production. Unfavored farm commodities would no longer be caught in an artificial price-cost squeeze. (6) Our foreign economic relations would immediately improve. We would no longer need to impose farm import quotas or try to dump surpluses abroad.

But while termination of further price guarantees or supports would prevent the present situation from getting still worse, as it otherwise threatens to do, it would not solve the problem of the huge \$7 billion worth of surpluses that the government already holds. This brings me to the second step of my proposed program. The government would *sell its existing surpluses back to the farmers themselves*. Each farmer might be allowed to buy an amount proportionate to that of his own production of a surplus commodity in preceding years. The government could assure the sale simply by offering the surpluses to the farmers at, say, two thirds of the world market price of each commodity at the moment of sale. Each farmer would be free to dispose of what he bought as he saw fit. He could store it at his own expense, or sell it through the speculative markets.

There would then be no need to subsidize the farmer to put his acreage in soil-conserving crops. Once again guided by free market prices, most farmers would realize the folly of raising more of a crop until the existing surplus was worked off. They would meanwhile have sufficient incentive to conserve their own soil.

It is true that the government would take a big loss in selling these surpluses back to the farmers. But most of this loss is inevitable anyway. It will be immensely greater, in fact, if the government continues with its present program. It is true that individual farmers would for a year or two be paid, in effect, for not raising crops in which surpluses existed. But the twin objectives of a “soil bank” and of getting rid of surpluses would be achieved.

The only alternative to halting present farm price supports is further losses to taxpayers, further piling up of surpluses, and ultimately much further harm to farmers themselves. ❁

## Arithmetic of Federal Aid

December 26, 1955

The present ballyhoo for Federal aid to local schools is one more example of the delusion that Federal money comes out of a sort of Fourth Dimension, and doesn't really cost anybody anything.

The chief argument for Federal aid is that the states and localities cannot afford to pay for their own

education. The moment we examine it, this argument vanishes into thin air. For the residents of the states and localities who “cannot afford” to pay for adequate education are the same people who would be called upon to pay increased Federal taxes to supply Federal aid. In *Newsweek* of Nov. 28, Raymond Moley discussed some of the fallacies of Federal aid to education, based on the excellent study by Roger A. Freeman, published by the American Enterprise Association in Washington, D.C. But here I should like to call attention especially to the economic and fiscal fallacies.

Freeman argues that, if anything, the states and localities are now in a better position to pay for education than the Federal government. State and local government debt is small compared to the huge Federal debt. Twenty-five years ago the Federal government collected one fourth of all taxes in the U.S.; today it takes three fourths. It is high time to reverse this trend.

When such facts are pointed out, some proponents of Federal aid are content to argue that the Federal government should aid the poorer states alone. Freeman points out what is wrong with this argument. The discrepancies in fiscal capacity among states have greatly narrowed in recent years. Between 1940 and 1953 the per capita income in the twelve highest-income states rose 37 percent in dollars of constant value, whereas in the twelve lowest-income states it rose 96 percent.

And Federal aid to the poorer states alone is *politically* so improbable as to constitute a daydream. Congressmen from New York may gain politically by getting Federal aid for New York; but they will get few votes in their own districts for taxing New Yorkers to help build schools in Mississippi. Experience has shown, in fact, that the only kind of bill for Federal aid to education that has a political chance in Congress is one which makes a flat per pupil grant to all states.

This was the kind of bill that actually emerged from the House Education and Labor Committee last summer. Under it, about half the Federal appropriations would go to the fourteen wealthiest states, and only a fourth to the fourteen poorest. As Freeman points out, the fourteen wealthiest states control 53 percent of the votes in the House of Representatives, and the fourteen poorest states only 23 percent.

The arithmetic of Federal aid, in brief, is entirely unsound. From where, then, does the constant political pressure come for Federal aid? From the very persons who ought to be the greatest defenders of states' rights, but who turn out to be among its greatest enemies. From many governors, state legislators, and local educators. The reason is not obscure. If state officials get Federal aid, they can argue to their local voters that they have brought benefits to the state without raising taxes. The argument is, of course, fallacious. The voters of the states and localities simply pay for schools in increased Federal taxes instead of increased local taxes. To be sure, the exact increase of the Federal tax burden on himself is much harder for the individual taxpayer to trace. The Federal government can even create the illusion that Federal aid doesn't cost anybody anything, because it can run a deficit and print more paper money.

The pressure for Federal aid to education, in sum, perfectly illustrates the delusion that funds appropriated by the Federal government are not really supplied by the voters of the states and localities, but come out of a sort of Fourth Dimension. The sad truth is that there is no magic in Federal aid; that everything has to be paid for; that if the Federal government helps to pay for local education it must end by controlling local education, and that states' rights will become a hollow shell. ❁

1956





## Why Spending Grows

January 2, 1956

The present proposals for still larger farm subsidies at the expense of the taxpayers are one more example of how Federal spending programs, no matter how huge or how harmful, tend to grow even greater.

The more than \$7 billion worth of farm surpluses already piled up in warehouses and old ships are the direct result of the 90 percent of "parity" price-support program. This piling up of surpluses, with its drain on the Treasury, continues even under the "flexible" price-support program. Yet the Democrats are pressing for a return to 90 percent support, and the Administration feels driven to suggest still greater farm expenditures. On top of present price supports, it now proposes to recommend a "soil bank" plan. Under this, in the first year, the taxpayers would be called upon to hand out some \$450 million more to induce farmers to put part of their acreage in soil-building grasses rather than in price-supported crops.

As the need for farm relief has grown less, farm relief itself has grown greater. In 1934, realized gross farm income was only \$8.5 billion; in 1944, it had jumped to \$24.4 billion; in 1955, it was about \$32 billion. Yet over the same period government farm subsidies have steadily mounted.

A similar growth may be traced in unemployment insurance, old-age assistance, and other social-security programs. In 1949 Edna Lonigan wrote a study for the American Enterprise Association of Washington, D.C., in which she showed not only how welfare programs had been steadily expanded but how the concept of what constitutes "need" had been steadily raised. Such a study, brought down to date, would show the same expansion going on in the last six years. A similar secular trend can be traced in the various veterans' programs.

Another dramatic illustration is the expansion of Federal grants-in-aid to the states and localities. More than 50 different grants-in-aid have been enacted so far. Roger A. Freeman, in his study of Federal aid to education that I referred to last week, tells us that these grants-in-aid have soared from \$3 million at the turn of the twentieth century to more than \$3 billion in 1955.

Another outstanding example is aid to housing. The various mortgage-guarantee programs and subsidies for public housing were originally enacted on the argument that they were needed to compensate for an abnormally low volume of private building. But these programs continue even during the greatest housing boom and the greatest general boom in our history.

In some respects the strangest of all examples is the foreign-aid program. Our government has now poured out more than \$50 billion in foreign aid since the end of the second world war. All the arguments for the institution of the Marshall Plan in 1947 have now evaporated. The aid was to last only four years. But under constant changes of name and reasons it continues in heavy volume.

What causes this constant rise in expenditures for the benefit of special groups? Why are the forces acting in the opposite direction so weak? The general principle at work was once summed up by Elihu Root, a senator and onetime Secretary of State. "Minorities punish," he said, "and majorities will not protect."

That this should be so in the realm of public expenditure is not mysterious. To the beneficiaries of Federal aid (which include the bureaucracy hired to direct it) it makes a direct and substantial difference whether or not they get it. The tax burden, on the other hand, is spread over the whole nation, and no taxpayer can be sure precisely how much a given spending program costs him personally. Therefore the steady flow of organized propaganda is all on the side of continuing that spending program, while the arguments put forward against it are scattered, and much more abstract and disinterested. They seldom carry a threat to the political life of any congressman.

A cure for this ominous trend would not be simple. But one part of it would surely be to adopt a really responsible budget system. ❀

## Hazards of Forecasting

January 9, 1956

"Cromwell was about to ravage all Christendom; the royal family was undone, and his own forever established, save for a little grain of sand which formed in his ureter. Rome herself was trembling under him; but this small piece of gravel having formed there, he is dead, his family cast down, all is peaceful, and the king is restored."

Perhaps nothing in literature more concisely and effectively illustrates the way in which apparently tiny causes can have tremendous effects than these two sentences from the great seventeenth-century mathematician and philosopher, Pascal. The world had another telling illustration of the hazards of forecasting in the year just passed. When President Eisenhower's heart faltered on Sept. 24, the whole economic outlook seemed to change overnight. On the Monday after that week end, the stock market opened with the most

violent drop since the panicky days of 1929, later to recover with the President's own recovery. Not one of those who had forecast business and market conditions at the beginning of 1955 had thought to condition his forecast upon the health of a single man.

Yet as the year turned out, the forecasters for 1955 went wrong for the strange reason that they were not optimistic enough. An article in the National Industrial Conference Board's December *Business Record*, with the witty title "What Went Right?" points out that "the consensus of forecasts for 1955 was certainly far wide of the mark." The forecasts were only moderately optimistic. In general they guessed that 1955 might be the "second best" year in our business history—better than 1954, but not as good as 1953.

When the forecasts were made, nothing in the statistical sky seemed to hint anything better than this. "While consumer demand had held up very well indeed during 1954, there was no very good evidence that it was about to advance into a wholly new range of spending." The assignment of cause and effect can be questioned, but the Conference Board article thinks it is "reasonably clear that, in 1955, personal consumption and related magnitudes of personal saving and personal debt were the dynamic and driving forces behind business. . . . Of all the records set during the year, the most impressive are the 7.5 million level of new car sales, and the \$5 billion—\$6 billion increase in installment debt outstanding. No other figures so clearly distinguish the year from all others. If the forecasters had known them a year ago, they would have needed little else to get on target." In other words, if the forecasters had known what was going to happen, they would have known what was going to happen.

If the consensus of the forecasts could go wrong for 1955, it can just as easily go wrong for 1956—and not necessarily in the same direction. It is the weakness of most forecasters to assume that conditions are going to continue as they already are—or, rather, to assume that they are going to change in the same direction and at the same rate as in the immediate past. In more technical language, the unconscious tendency of most forecasters is to "extrapolate" the recent business curve.

Let us study the present forecasts therefore, with appropriate caution. All of us must base our decisions on some guess regarding the probable future. But we should do well to keep in mind that business forecasting can never be a science. The future does not depend on any set of past or present statistics, or any extrapolation of them, but on a million future developments which no one can foresee. The best forecast can be based only

upon apparent *probabilities*; but "probabilities" can be falsified by events.

As the Conference Board's article concludes. "It is not easy to say what the lesson of 1955 should be. Should the performance of consumption in 1955, which was extraordinary by the standard of all preceding years, be counted on for 1956? . . . Or does the boom in personal spending in 1955 presage . . . a steep return toward an historical 'normal'? . . . The answers to these questions are very much the answers to 1956." ❁

## Foreign Aid Forever?

January 16, 1956

The request of the Administration for an appropriation of almost \$5 billion for foreign aid, as compared with \$2.7 billion for the current fiscal year, is so ill-advised and unjustified that all I can do here is to list some major objections to it, and leave further elaboration to a later time.

1—Secretary Dulles's defense of this request is that the actual rate of foreign-aid *spending* will increase from \$4.2 billion in the current fiscal year to "only" \$4.4 billion in the fiscal year beginning next July 1. His defense of an 80 percent increase in the *appropriation* is that it is necessary to keep foreign aid flowing, to keep the "pipeline" filled up. Yet even without this addition to its foreign-aid reserves, the Administration will have a \$7 billion carry-over of foreign aid appropriations at the end of this fiscal year.

Moreover, the Administration's present line is a complete reversal of its previous attitude on budgetary carryovers. At a press conference on April 30, 1953, President Eisenhower said: "No more glaring illustration of the lack of balance between the military logic and the economic logic could possibly be found than the situation that existed when we took office. On the one hand, we found our Allies deploring our unfulfilled defense promises. On the other hand, we found that there was a total carry-over of \$81 billion in appropriated funds, largely committed, for which cash must be provided from revenues in future fiscal years, over and above the normal cost of government. It's just as if the late Administration had gone to the store and ordered \$81 billion of goods, which we've got to pay for as they're delivered."

If Mr. Eisenhower was right in 1953, he is wrong now. A larger appropriation now means that the taxpayers must spend that much more, whether in the next fiscal year or later. Only by rejecting the present demand can Congress hope to control even future foreign aid,

not to speak of bringing it to a long-overdue termination. The suggestion of a pledge to continue foreign spending for ten more years is an unwarranted attempt to tie the hands of future Congresses.

2—We have already spent \$50 billion of the taxpayers' money in foreign aid since the end of the second world war. Propagandists for this aid boldly give it entire credit for the postwar European recovery that has taken place. But it could just as plausibly be argued that this recovery would have been faster without it. Certainly it has subsidized and prolonged foreign exchange controls and socialism.

3—As the old excuses for foreign aid run out, our bureaucrats invent new ones. The present somewhat hysterical clamor for it rests on the tacit assumption that allies can be bought if we only raise our price. We are told we must outbid Russian offers of foreign aid. Yet even Secretary Dulles admitted that we ought not "to put ourselves in a position where the Soviets, by just making paper offers, can require us to make real offers to top them. That would mean that the Soviets would be spending nothing except a piece of paper but would require us to spend a great deal of money." Yet this is precisely what we are doing, for example, in offering American taxpayers' money to help Egypt build a grandiose dam.

4—The tacit assumption behind nearly all our so-called foreign "economic aid" has been statist or socialistic. It assumes that a nation prospers by handouts, rather than by attracting private investments through encouragement of free enterprise.

5—Even our so-called "military aid" rests on the dubious economic assumption that other countries can not afford to pay for their own defense, and that American taxpayers must assume that burden.

6—The foreign-aid program is merely one more symptom of budget irresponsibility. The Administration is not only asking more for foreign aid, but more for agriculture, more for highways, Federal aid for local schools, and so on. It wants to give other nations more than \$4 billion a year, though we groan under onerous taxes, we haven't yet balanced our own budget and are already \$280 billion in debt. ❁

## The Presidential Burden

January 23, 1956

President Eisenhower's State of the Union message calls in substance for the continuance and expansion of the measures and principles of the New Deal-Fair Deal. It asks for increased spending on foreign aid, farm aid,

and on a vast highway system; for more housing subsidies, bigger social security, new Federal spending on local schools, "distressed areas," flood insurance, and health reinsurance. Everybody is remembered but the taxpayer who is to pay the bill.

Most of the estimated 46 or more legislative measures for which the President calls are not only unnecessary, but would do more harm than good. Yet one of the most urgent steps that the new session of Congress ought to take was not even mentioned in the President's message. This is a measure or set of measures: (1) To relieve the present tremendous burden of work and responsibility on the Presidential office; (2) to allow a President, in case of disability, to delegate whatever powers he thinks necessary to the Vice President, and to terminate this voluntary delegation of power at will; and (3) to provide for the delegation or transfer of Presidential power whenever a President can no longer "discharge the powers and duties" of his office, but is either unable (as was Garfield) or unwilling (as was Wilson) to acknowledge his own inability.

1—The need of reducing the tremendous burdens on the Presidency is acknowledged on all sides. Former President Herbert Hoover, in a recent television interview, made the interesting suggestion that "what we need is a new Administrative Vice President to be selected by the President and assigned such duties as he may wish." The essence of this suggestion is sound, but there may be wide differences of opinion about details. It would certainly be confusing to have two men with the title of Vice President, one elected as such, and the other an appointed official. It would be perhaps more practicable to permit the President (by written authorization) to distribute much of his present detail work among his existing Cabinet officials, and in addition to permit the appointment (with Senate approval) of a new member of the Cabinet, a Secretary General to whom the President could delegate such other enumerated duties or powers as he thought wise.

Mr. Hoover pointed out that there are now 64 agencies of government that report directly to the President. He thinks that something like 35 or 40 of them could be placed, with the authority of law, under the "Administrative Vice President" he suggests. It would seem even more practical, to the present writer, to abolish some of these 64 agencies of government. The tremendous burdens and responsibilities put upon the President are caused primarily by the fact that our government itself has grown too big. It attempts to meddle in too much. It attempts to formulate and enforce more policies than can be encompassed by the mind of any



one man. When this happens, the government is bound to fall into disorder and confusion.

2—As I have already suggested (*Newsweek*, Oct. 17, 1955), it would seem to come well within the Constitution for Congress by legislation to allow the President, in case of his temporary disability, to delegate as much of his powers and duties as he sees fit to the Vice President, and also to withdraw this delegation when his disability ends.

3—The most difficult problem is that of deciding who should determine Presidential “inability” in the event of a President himself being unable or unwilling to do so. One course which has been suggested is that Congress prescribe by law that the officials named in the Succession Act of 1947 should inquire into such a question when it arises, and either report its findings of fact to Congress, or itself make the decision.

Congress could of course take the first two measures listed above even if it could not agree on the more difficult third problem. But as already demonstrated in the Garfield and Wilson Administrations, Congress is taking a needless risk as long as it allows this important constitutional problem to remain clouded in doubt. ❁

## A Farm-Vote Program

January 30, 1956

The President's farm message is a strange document, full of contradictions. It opens with an unsparing criticism of the farm price-support program. “Mountainous surpluses overshadow everything else,” because “war-time production incentives were too long continued. . . . Were it not for the government's bulging stocks, farmers would be getting far more for their product today. . . . Both at home and abroad markets have been lost. Foreign farm production has been increased. American exports have declined. Foreign products have been attracted to our shores. . . . Our farmers have had to submit to drastic acreage controls. . . . Even these controls have been self-defeating.”

The logical conclusion from all this would be to stop government farm price support as soon as feasible. Instead, the President attributes all these evils to the Democratic price-support program at 90 percent of “parity.” He assumes the evils will end under Republican “flexible” price support at 75 to 90 percent of parity. No doubt, at slightly lower artificial price props surpluses may pile up at a less appalling rate than otherwise; but they will pile up. “We must stop encouraging the production of surpluses,” says Mr. Eisenhower; and then endorses a plan which must continue to encourage them.

He realizes this; for he immediately proposes another plan to offset this encouragement. This is a “soil bank,” designed to take at least 40 million of the country's 350 million acres of crop land out of production. These would be planted to trees or grass. Participating farmers would be forbidden even to graze cattle on any land put in the “acreage reserve.”

In other words, under the price-support program, the farmer is given a subsidy to encourage him to produce surpluses, while under the soil-bank program he would get another subsidy to *discourage* production of surpluses. He would be offered one handout to increase production and then another handout if he agreed not to take advantage of the first one.

This “solution” is full of question marks. The sheer administrative problem of enforcement of this soil-bank program would be enormous. In one part of the message the President admits that acreage controls are almost worthless. “In 1955, on an acreage allotment calculated to yield 10 million bales of cotton, nearly 15 million were harvested.” In short, production per acre can be increased amazingly—given an artificial price incentive. Therefore, beginning with the crop of 1957, the President suggests quantity allotments for cotton instead of acreage control. But acreage control would also be worthless for other crops as long as their prices are government-supported. The whole plan would lead toward complete regimentation of farming, with each farmer told exactly how many pounds or bushels of every crop he could sell, based on his “historic” production.

The President's message piles up so many subsidies, handouts, and administrative headaches that it is impossible even to list them here. But he does suggest that Congress “consider placing a dollar limit on the size of price-support loans to any one individual or farming unit. . . . Price-support loans of tremendous size have occasionally occurred.” He doesn't mention figures, but the records show that payments of more than a million dollars have been made to individual farms for growing cotton that nobody wanted to buy. This is surely carrying “relief” to the “needy farmer” pretty far.

Yet while putting a limit on the size of the price-support check to any one farm may mitigate this scandal, it only underlines the absurdity of the whole price-support program. Something like 85 percent of our total farm output comes from the big, efficient farms that are the main beneficiaries of the program. To continue price support mainly to the small producers would be to subsidize and encourage much costly and inefficient at the expense of efficient production.

But hoped-for political advantage is likely to play a much greater role in any new farm program than probable economic consequences. ❁

## But Is It Balanced?

February 6, 1956

President Eisenhower has abandoned a philosophy of economy to embrace a philosophy of spending.

The evidence of this reversal lies in his budget message for fiscal 1957—in the overall spending estimates, the detailed spending programs, and in pronouncements in the message itself. In the fiscal year 1953 the government spent \$74.3 billion. In fiscal 1954 it spent \$67.8 billion; and in fiscal 1955, \$64.5. The budget which the President submitted a year ago, for the current fiscal year to end on June 30, estimated spending at \$62.4 billion. Now the trend has been reversed. Mr. Eisenhower estimates that in the current fiscal year the government will actually spend \$64.3 billion, an increase of nearly \$2 billion above his estimate a year ago. In the new fiscal year, to begin on July 1, expenditures are estimated at \$65.9 billion.

Less than \$1 billion of this increase for fiscal 1957 can be blamed on the increase in military expenditures. Practically every other major category of spending is higher—foreign aid, veterans' benefits, labor and welfare, farm subsidies, housing subsidies, general governmental expenses. And the new spending programs suggested are too numerous to list here. In order to obtain a substantial surplus in the 1957 budget, or to permit of a substantial tax reduction, it would not have been necessary to find new economies, but merely to refrain from any new spending above that originally contemplated for fiscal 1956.

The reversal in the President's spending philosophy is apparent in the message itself. "A significant increase in revenues is currently anticipated," the President declares, "as the result of our present unprecedented prosperity. In the achievement of this prosperity, the historic \$7.4 billion tax reduction and reform program of 1954 . . . and the confidence born of prudent fiscal and credit management have been strong energizing factors." But later on in the message he declares: "Budget revenues now permit us to undertake some new and expanded programs for enhancing opportunities for human well-being and economic growth." This second passage seems to justify more spending mainly on the ground that the government will have more money to spend. It assumes that the way to prosperity and well-being is not to economize and cut taxes, as assumed

in the first passage, but to keep up taxes and add new spending programs. It deserts the philosophy of providing incentives for the philosophy of the handout.

The President's estimate of a balanced budget for 1957, moreover, is not convincing. I have printed tables several times in this column to show the persistent discrepancy between estimates and realities in the budgets of the Roosevelt and Truman Administrations. Mr. Eisenhower's record is no better. He originally estimated a deficit for fiscal 1955 of \$2.9 billion; it turned out to be \$4.2 billion. For fiscal 1956 he estimated that budget receipts would be \$60 billion and expenditures \$62.4 billion. He now estimates expenditures in fiscal 1956 at \$64.3 billion, or nearly \$2 billion higher; but the situation is saved because estimated receipts are miraculously \$4.5 billion higher.

Now these receipts have come because 1955 turned out to be the year of the greatest prosperity and greatest national income on record. Yet instead of considering this perhaps an abnormally high income, continuance of which it might be imprudent to count on, the President actually assumes that 1956 will be an even more prosperous year than 1955, and that revenues will be \$1.8 billion higher. He gets this result in part through the dubious assumption that Congress will approve a \$350 million postal-rate increase at this session, although it refused to do so last year. And he makes his fiscal 1957 budget "balance," also, by providing no funds whatever for the new Federal highway program he is recommending. If his slim and precarious surplus for the fiscal year 1957 is actually to be realized, this whole series of doubtful assumptions must turn out to be right. The country desperately needs a responsible budget system. ❁

## Facing Both Ways

February 13, 1956

Like his Budget Message, President Eisenhower's Economic Report seems to preach two mutually contradictory philosophies at the same time. It pays lip-service to government economy and free enterprise, and ends with scores of recommendations for increased spending and more governmental controls.

It is perhaps forgivable, especially in an election year, that the Administration should congratulate itself on the astonishing economic record of 1955, and imply that the result came about because, as Franklin Roosevelt once boasted, "we planned it that way." "Full employment, rising incomes, and a stable dollar have been cherished goals of our society. The practical

attainment of these ideals during 1955 was the year's great economic achievement."

But what caused this result? The report begins, modestly enough, by admitting that "lasting prosperity of the nation depends far more on what individuals do for themselves than on what the Federal government does or can do for them." It adds: "Today we believe as strongly in economic progress through free and competitive enterprise as our fathers did, and we resent as they did any unnecessary intrusion of government into private affairs." Then a qualification is added which, as it turns out, practically nullifies this statement. "But we have also come to believe that progress need not proceed as irregularly as in the past, and that the Federal government has the capacity to moderate economic fluctuations without becoming a dominant factor in our economy."

Under the multitude of measures the report proposes, however, the Federal government would obviously become *the* dominant factor in our economy. For the President and his economic advisers are now apparently convinced that "wise and timely actions by the government" and "soundly conceived and well-timed governmental policies" can smooth everything out, give us exactly the right rate of growth, and "prevent a minor contraction from turning into a spiraling depression." In order to do this, it seems that some 53 new laws or policies on the part of the Federal government would be required. Most of these would greatly increase Federal powers. They imply interventions in the private economy at a thousand points, and a constant stream of government subsidies and handouts.

Moreover, even the specific governmental policies proposed contradict each other. This is most clearly brought out in the recommendations for credit controls. The Federal government should be empowered to set "minimum down payments and maximum maturities on installment credit," because "installment credit sometimes accentuates swings in the buying of automobiles, furniture, television sets, and other consumer durables, thereby exposing the rest of the economy to the hazards of widened fluctuations."

But the same government that fears the too-rapid growth of installment credit, even when financed by private lenders at their own risk, has promoted an enormous housing boom by itself guaranteeing mortgages on shoestring margins that make the installment-credit terms on automobiles or television sets look like the acme of conservatism. It has forced Americans who want to invest in American corporations to pay down 70 percent of the purchase price, while it uses the taxpayers'

resources to encourage other Americans to buy houses for 7, 5, 2, or 0 percent of the purchase price.

The Federal Reserve authorities, bluntly, have not had the courage to exercise a sufficiently firm control over the total volume of bank credit. They have kept down interest rates below the levels to which they would otherwise have gone. It is this that has encouraged and made possible the huge growth in consumer credit. It is futile economically, and dangerous politically, to give governmental authorities the right to increase the total supply of credit to make it cheaper and easier, and then to ration the oversupply by stepping in to say who shall and shall not have credit and on what terms. This substitutes bureaucratic judgment and favoritism for the judgment of the market place. ❁

## Mencken: A Retrospect

February 20, 1956

H.L. Mencken, who died on Jan. 29, was the outstanding American literary critic of his generation, its most influential stylist, its most prominent iconoclast, the chief scourge of the genteel tradition, and a great liberating force.

I devote this column to him in the hope of correcting a persistent misunderstanding about his economic and political ideas. The typical view, reflected in most of the obituaries, is that Mencken began as an archrebel and idol smasher; but that when the New Deal came along, he could not keep abreast of its "progressivism" and its "new ideas"; so the procession passed him by, exposing him as a mere "conservative."

Those who hold this view have never understood either the real nature of the New Deal, or the real philosophy of Mencken. That philosophy never changed. Mencken was first and foremost a libertarian. That explains his unceasing warfare against censorship and prohibition, and most of his assaults on "democracy"—insofar as that word was used to imply the right of a majority to suppress or persecute a nonconformist minority.

I can speak about his views with a certain confidence, not only because I devoured all his work as it came out, but because of close personal experience. When Mencken nominated me in 1933 to succeed him as editor of *The American Mercury*, he thought I understood his philosophy and he mine well enough to assure his readers that in the magazine's "basic aims and principles there will be little change."



In his political and economic opinions Mencken was from the beginning, to repeat, neither “radical” nor “conservative,” but libertarian. He championed the freedom and dignity of the individual. Therefore he always considered Socialism preposterous. He had never known a Socialist, he was fond of saying, who wasn’t crazy on other subjects as well. One of his very earliest books, *Men vs. the Man*, published in 1910, was a debate against a Socialist. His famous blast against “this Prof. Dr. Thorstein B. Veblen, head Great Thinker to the parlor radicals, Socrates of the intellectual Greenwich Village, chief star [at least transiently] of the American Atheneums,” appeared, it is important to recall, in 1919, in the very first series of the *Prejudices*, and at the beginning of the great Mencken vogue.

Veblen remained the darling of the American intellectual left-wingers for at least twenty years longer. When the New Deal was at the height of its power and prestige, it was fashionable to say that Mencken had “missed” Veblen because he could not make him out. Now that the once exorbitant reputation of Veblen is itself rapidly fading, it is perhaps permissible to point out that whatever was sound in his celebrated *The Theory of the Leisure Class* had already been said, in a few brief paragraphs, by Aristotle; and that Veblen’s attacks on “the price system” came from a man who had not the remotest understanding of that system, or of the role it plays in stimulating, directing, allocating, and balancing production.

Mencken was not a technical economist. He did not possess the specialized intellectual implements necessary to dissect all the Veblenian fallacies. His own essay, in fact, was published a couple of years before Veblen’s “The Engineers and the Price System.” But Mencken had an almost unerring sense of smell. He could usually detect pretentiousness and nonsense at the first whiff. True, his essay begins with an attack primarily upon the professor’s “incredibly obscure and malodorous style.” But when he got to his ideas he excoriated them irreparably, and concluded: “From end to end you will find the same tedious torturing of plain facts, the same relentless piling up of thin and over-labored theory, the same flatulent bombast, the same intellectual strabismus.”

In short, Mencken recognized from the start that Veblen’s ideas were “simply Socialism and water.” He prized human liberty too highly to be carried away by the growing academic mania for collectivism. Like Herbert Spencer, he sensed that “all Socialism involves slavery.” He brought in the minority report. ❀

## The War on Big Business

February 27, 1956

Recent actions and proposals of the Eisenhower Administration with respect to big business are disturbingly like those of the New and Fair Deals. Once more mere bigness is being treated as a crime in itself.

Stanley N. Barnes, Assistant Attorney General in charge of the Department of Justice Antitrust Division, hinted, in a speech on Feb. 8, at the possibility that antitrust action would be taken against the country’s major automobile manufacturers, because the three biggest producers now turn out almost 95.5 percent of the cars. Yet the United States has achieved by far the greatest industrial productivity that the world has ever known. And if one industry stands out above all others as the wonder and envy of other nations, it is our automobile industry. Nowhere is there keener competition in price, quality, and output. The intense competition *between* companies, in fact, forces competition nearly as keen *within* companies. The Oldsmobile competes for the consumer’s favor and dollars with the Buick, the Chrysler with the Imperial, the Ford with the Mercury.

But, alas, this intense competition does not fit the Justice Department’s preconceived numerical notions of what competition ought to look like. If there were twenty automobile companies, each doing forever just 5 percent of the business, the department would apparently be satisfied. What alarms it is that a few companies should achieve the goal of competition by being more successful than their rivals and attracting a higher percentage of consumer buying.

Even more disturbing evidence that there is something basically wrong with the Administration’s new attitude toward big business was the announcement by Attorney General Brownell on Jan. 24 of a “consent decree” under which the American Telephone & Telegraph Co. was compelled, among other things, to license 8,600 existing patents to all applicants without royalties. But what is the consistency or sense in granting patents by act of Congress, and then forbidding companies, by bureaucratic decree, to take advantage of such patents? Will the big companies continue to spend as much on research when they know they will be forced to give away what they discover? In the long run, will “consent” decrees of this sort advance scientific and technological progress—or retard it?

A final touch of “antitrust” absurdity is found in the consent decree announced on Feb. 6 forcing the Hilton Hotels Corp. to dispose of two of its 27 hotels within “a reasonable time.” It must sell, for example either the New Yorker or the Roosevelt in New York, so that it



will have only four hotels in that city under one management instead of five. Just what will this accomplish? How does the Department of Justice know that in a city containing 400 to 500 hotels, the ownership of just five of them by a single management constitutes a threat of monopoly, but the ownership of four does not? Does the common ownership of five hotels reduce the number of rooms available? Does it make "monopoly pricing" possible? Incidentally, are local hotels in interstate commerce?

Not the least curious thing about this sudden pre-election ardor against "monopoly" is that it utterly ignores the most serious monopoly of all—that of industrywide unions. These unions, in the railroad, automobile, steel, or coal industries, can at any time paralyze the economy of the whole nation until their demands are met. Yet instead of showing concern, the government deliberately builds up their power by making it illegal for an employer not to "bargain" with them.

Our antimonopoly laws need thorough revision. They should be clear, general, and, as far as possible, equal and certain in their application. Such vague formulas as "undue concentration of economic power" can mean anything an individual bureaucrat or judge wants them to mean. In the present nebulous and contradictory state of our antimonopoly laws, we are bound to suffer from government by bureaucratic caprice and discrimination. The legal and political consequences of this can be as serious as the economic consequences. ❁

## 'Selective' Credit Control

March 5, 1956

Secretary Humphrey showed political courage as well as excellent sense when he refused to endorse the suggestion in the President's Economic Report for restoration of the government's power to regulate the terms of consumer installment credit.

The Secretary also gave the right reasons why such stand-by powers would be inadvisable. They would put too much discretion in the hands of whoever was to administer them: "You take a great responsibility on yourself when you tell 160 million people what they can afford to buy." Chairman Martin of the Federal Reserve Board also pointed out that: "Selective controls of this nature are at best supplements and not substitutes for the general overall credit and monetary instruments."

The most eminent advocate of the imposition of stand-by controls on installment credit is Allan Sproul, president of the Federal Reserve Bank of New York. In a speech on Dec. 29 he declared: "I do believe that

there is a temptation to abuse consumer credit in boom times, that it can thus become a serious source of instability in our economy, and that we would not jeopardize our general freedom from direct controls by giving the Federal Reserve System permanent authority to regulate consumer credit."

But Sproul's argument indirectly admits that he wishes this power in order to avoid a sufficiently firm control over *general* interest rates and the *total volume* of credit: "If there has grown up a form of credit extension which . . . is introducing a dangerous element of instability in our economy, and if it is difficult to reach this credit area by general credit measures without adversely affecting any of the less avid users of credit is there not a case for a selective credit control?" What Sproul is saying in effect is that a handful of government monetary managers should be given the power to discriminate among borrowers; to say which are "legitimate" and which not; to say just who should have credit and on what terms. No government body should have such power. It becomes an implement for political favoritism.

President Eisenhower declared in a press conference on Feb. 8 that if the government were granted stand-by powers over consumer credit they would not be abused. But the record shows that the "selective" powers over credit which already exist have already been abused. Our Federal Reserve authorities complain of "inflationary pressures." Yet they keep the official discount rate down to only 2½ percent. (Compare this with Great Britain, which has just been forced to raise its discount rate to 5½ percent.) And they have allowed and encouraged a \$12 billion increase in the total volume of money and bank credit since the beginning of 1954.

The government authorities discriminate against purchase of corporate securities by compelling a minimum down payment of 70 percent. They discriminate in favor of purchase of houses by pledging the taxpayers' money to allow such purchases for a down payment of only 7 percent or perhaps only 2 percent. A Congressional subcommittee has recently raised a storm about even these tiny down payments. It has asked for a return to the conditions under which a veteran could buy a \$10,000 house without putting up even the \$200 cash now required. The belief that government agencies are above the political pressures which lead to such discriminations among borrowers has been disproved everywhere.

In sum, if general interest rates are allowed to rise to their appropriate level, and if there is a sufficiently firm rein on the total quantity of credit, "selective" credit controls are unnecessary. But if there is *not* a sufficiently firm rein on the total quantity of money and credit,

“selective” controls are largely futile. If a man has \$2,500 cash, for example, but can buy a \$10,000 house for only \$500 down, then he can also buy a \$2,000 car with his “own” cash, whereas if he had to pay down his \$2,500 for the house he couldn’t buy a car even on pretty loose credit terms. This elementary principle of the shifting or substitution of credit seems to have been overlooked by the champions of “selective” credit controls. ❁

## That Gas Bill Veto

March 12, 1956

President Eisenhower’s veto of the natural-gas bill was confused, irrelevant, and a political blunder. It cannot be defended logically, constitutionally, or economically.

Most of this is clear from the text of the veto message itself. The President declares that “legislation conforming to the basic objectives” of the bill “is needed because the type of regulation of producers of natural gas which is required under present law will discourage individual initiative and incentive to explore for and develop new sources of supply. In the long run this will limit supplies of gas, which is contrary not only to the national interest but especially to the interest of consumers.” That accurately sums up the economic need for the bill.

In addition the President might have asked whether the Federal government has any business regulating the price of a commodity before it enters interstate commerce, and whether the Supreme Court, in its 5-to-3 decision of June 7, 1954, did not usurp legislative functions and flout the plain intent of Congress itself. Congress specifically exempted from the provisions of the Natural Gas Act of 1938 “the production or gathering of natural gas.”

But the President deliberately set aside the merits of the case, and the interests of more than 20 million consumers, in order to punish the “highly questionable activities” of a few “private persons, apparently representing only a very small segment of a great and vital industry.”

The only proper procedure was to decide each question—the question of natural-gas regulation, and the question of improper influence on Congress—on its own merits. That is what the Senate majority tried to do. By the President’s own admission, he is punishing some 8,000 natural-gas producers and more than 20 million consumers, continuing a practice that is more dubious constitutionally, and supporting an indefensible Supreme Court decision, all because one gas producer had acted improperly and stupidly in

trying (unsuccessfully) to influence one or two votes in Congress.

The President’s veto message, unfortunately, did more than this. His veto was based on “efforts I deem to be so arrogant and so much in defiance of acceptable standards of propriety as to risk creating doubt among the American people concerning the integrity of governmental processes.” But it was the President’s veto message itself that did most to cast doubt on “the integrity of governmental processes.” For the Senate voted *after* the facts in the Case affair had been publicly aired—by the Senate itself. The vote was not along party lines. Thirty-one Republicans voted for the bill and fourteen against it. Twenty-two Democrats voted for it and 24 against it. By implication the veto message threw doubt on the motives of the majority that voted *for* the bill—though there was also a powerful lobby against the bill.

The economic and constitutional case in favor of the bill is overwhelming. There is no argument against the Federal regulation of some 110 interstate pipeline companies, and local regulation of some 1,200 public-utility gas companies; but under the present Supreme Court decision the Federal government is regulating some 8,000 intensely competitive producers who take a great risk every time they dig an exploratory well. (Over a period of years producers are estimated to have drilled an average of eight exploratory “dry holes” for each successful one.)

It is estimated, moreover, that 90 percent of the gas bill paid by the ultimate consumer goes to the pipeline company and the local public utility to cover the cost of transmission and distribution. In other words, even if the producer gave his gas away, absolutely free, the average household consumer could cut his gas bill only about 10 percent.

Finally, if gas prices can be regulated by the Federal government at the individual well, it is certainly as logical for it to regulate petroleum prices locally—not to speak of coal, farm products, automobiles, or anything that eventually finds its way into interstate commerce. ❁

## Ike and the Economic Outlook

March 19, 1956

It is still too early to say precisely what effect the willingness of Mr. Eisenhower to run for a second term will have on the future of business.

We cannot judge too much from recent mercurial reactions of the stock market. At the moment

the most probable outlook is for a race between Mr. Eisenhower and Stevenson. But it is far from certain that the outcome will be the same as four years ago. Mr. Eisenhower's personality and policies are better known to the voters now than they were then. The impression left by his personal earnestness, candor, dignity, sense of duty, and absence of malice is perhaps even more favorable now than in 1952. But his reputation as an efficient administrator, or as a statesman with a firm grasp of political and economic principles, has considerably diminished. And any turn for the worse before November in either the domestic or the foreign situation will hurt his chances.

He started off well. He promised a drastic reduction of governmental expenditures, and a balanced budget. He ended a stalemated war in Korea. He removed price controls. But in the last year—and especially since his heart attack—his program has turned more and more into a mere extension of the political and economic policies of the New Deal. Details of the drift toward “ever-expanding Federal power and paternalism” were summarized in this column of Aug. 22 last. Recent developments have emphasized present New Deal tendencies in foreign aid, farm aid, housing aid, loose fiscal policy, big spending, and money and credit expansion to sustain an inflationary boom.

The net result of these recent policies and tendencies has been to alienate the conservative Republican vote, which constituted a large and perhaps determining factor in the election of 1952. In recent months, moreover, Mr. Eisenhower and his aides have made several grave political blunders. The two most important were Secretary Dulles's inept “brink of war” interview, and Mr. Eisenhower's illogical veto of the natural-gas bill in a message which cast doubt upon the integrity of the votes of the very senators who thought they were supporting him.

As a result of all this, it is extremely doubtful that the Republicans can win a majority in the forthcoming Congress. It is even far from certain that Mr. Eisenhower can win the election against Adlai Stevenson. For even if neither side were to say another word about it, Mr. Eisenhower's heart attack is bound to be an important issue in the campaign. The voters are certain to weigh much more heavily than they usually do the possibility that the Vice Presidential candidate may become the President. Stevenson, on his side, is a very articulate, astute, and ruthless campaigner, adroit in making mountains even out of molehills. It would be the height of folly for the Republicans to ignore Senator Knowland's warning that in the forthcoming election “not a thing can be taken for granted.”

Mr. Eisenhower, again, is repeating and magnifying the very blunder that defeated Governor Dewey in 1948. This is the blunder of presenting to the electorate a halfhearted copy of the New Deal, on the theory that this will capture the “middle of the road” voters, and that the regular orthodox Republicans have “no place else to go.” These voters, however, did and do have one place *not* to go—and that is to the polls. They refrained from doing so in the millions in 1948. That is what defeated Dewey.

In sum, in a race today between Eisenhower and Stevenson, the voters would be presented, so far as policy is concerned, only with a choice between the original New Dealer and their Johnny-come-lately imitators. Those voters who look with concern upon the steady growth of centralized government, of paternalism, of big spending, of subsidies for every pressure group, of continued inflation, and the steady erosion of states' rights, will have no candidate who reflects their views—except in the improbable event of the formation of a third party of conservatives drawn from both the Republican and Democratic ranks. ☼

## Extending the Farm Folly

March 26, 1956

Any farm legislation likely to emerge from the present Congress gives no promise of solving the farm problem. Its most probable result will be to make the problem much worse.

The Administration won a victory when the Senate voted to retain flexible price supports of 75 to 90 percent on most “basic” commodities, and defeated the effort to restore rigid 90 percent supports. But the Administration paid an excessive price for this “flexibility” by offering all sorts of concessions and new subsidies in order to win it. And it suffered a stunning setback in the discriminatory “two-price” vote for wheat.

In his farm message of Jan. 9 President Eisenhower correctly pointed out that “mountainous surpluses overshadow everything else. . . . Were it not for the government's bulging stocks, farmers would be getting far more for their product today. . . . Even [acreage] controls have been self-defeating.” He therefore proposed that, in *addition* to continuing to offer a subsidy to the farmer to overproduce, the government should try to offset this by offering him still another (“soil bank”) subsidy for *not* producing. “I do not propose this program,” he said, “as a device to empty government warehouses so that they may be filled again. There is,



therefore, a basic corollary to the acreage reserve program: In future years we must avoid, as a plague, farm programs that would encourage the building up of new price-depressing surpluses."

There is every reason to suppose, however, that the new price-support legislation would continue to encourage the building up of price-depressing surpluses and would keep the government warehouses filled. It seems likely to prolong the burden on the country's food consumers and taxpayers, lead toward increased regimentation of farming, and create further ill will by threatening the price stability of foreign-grown farm products. In brief, this country would be better off without these proposed changes in farm legislation.

There is only one certain way to stop the building up of demoralizing surpluses. This is to halt the price supports that encourage the production of such surpluses. If even "moderate" price supports are continued, they should in no case apply to any new crop as long as the government still holds a surplus of any past year's crop. If the government were to support wheat (or any other crop) even at 76 percent of "parity," for example, it should be free to resell its holdings in the open market at, say, 77 percent of parity (plus storage and handling costs). Whenever the 76 percent "floor" was reached, farmers would be automatically put on notice that no price supports would apply to any *new* plantings of wheat until the government had got rid of accumulated surpluses. The farmer would have to plant and dispose of any new crop entirely at his own price risk. This is the only type of price-support program that would not risk foreign resentment or the accumulation of mounting surpluses from year to year.

It is probable that only a drastic program could extricate farmers and the government from their present predicament. The surpluses of each crop could either be given away to the individual farm unit in proportion to its "historic" annual production, or sold to it at a price substantially below the world price. Each farmer could then make his own decision whether to resell his allotted share of the surplus immediately, or hold it for a rise at his own cost and risk. Any new market price so established would doubtless discourage new production for a year or so; but the farmer would be compensated financially by the share of the crop surplus either given to him, or sold to him, below world prices.

The farm problem has become so grave as a result of the high government price supports of the last seven years that nothing short of some such bold slashing of the Gordian knot could restore orderly, balanced production and free markets. But instead of arranging to terminate government price supports and surpluses,

both parties have been competing with each other to pile up new subsidies. ❁

## That Egyptian Dam

April 2, 1956

The proposal that the U.S. Government and its agencies pour hundreds of millions of our taxpayers' dollars into a grandiose dam in Egypt has at least one merit. It illustrates almost every bad principle involved in our foreign-aid program.

1—The High Dam at Aswan is to be more than 3 miles long, to cost \$1.3 billion (at least half of Egypt's estimated national income), and to take some fifteen years to build. Our proposed aid is called "economic"; but indirectly it is military aid. The less the Egyptian Government needs to lay out for its own dam, the more funds it will have left over for buying armaments. When the dam is completed it will no doubt supply power to create still more armaments.

2—This is one more plan for our government to subsidize foreign state socialism. The Aswan High Dam is doubtless inspired by the Dneprostroi dam and hydroelectric plant, the prewar pride of Soviet Russia, which also inspired our own TVA. The Dneprostroi dam was not justified by economic results. (See Boris Bratskus, *Economic Planning in Soviet Russia*, 1935.) State-directed "industrialization" programs are usually disguised militarization programs.

3—One of the originally declared objectives of the Marshall and other foreign-aid programs was to "combat Communism." Yet this money and aid are to be given to a country that is buying arms from Communist countries and pursuing foreign policies that coincide with the purposes of those countries. One of the favorite arguments for our foreign aid is that it tends to halt Communism by providing foreign countries with higher living standards. This is a naïve belief. In the decade since the second world war there is no evidence that higher living standards, when achieved, have been accompanied by marked decline in Communist sentiment.

4—Our foreign-aid program, both directly and indirectly, tends to discourage and delay a return to the principles of free enterprise in foreign countries. We do not encourage free enterprise by subsidizing socialistic ventures. Moreover, when we so freely offer government-to-government loans or gifts we make it unnecessary for "underdeveloped" countries to undertake the reforms or give the assurances calculated to attract private capital, either native or foreign.



5—Another favorite argument for our foreign-aid program has been that it is needed to win “allies” Experience daily shows however, that our foreign aid often has precisely the opposite effect. The countries that are gracious enough to accept our handouts insist that there must be “no strings attached.” In plainer words, our money must be given to them unconditionally. In consequence, we have abandoned even the most essential conditions. Only a few days ago Secretary Dulles announced that “there is no connection what so ever” between giving U.S. economic aid and securing U.S. allies. He went on to point out that Pakistan had security arrangements with the U.S. but not India or Ceylon; yet all three are receiving U.S. aid. Our foreign aid advocates begin to remind us of Santayana’s definition of a fanatic—one who redoubles his efforts when he has forgotten his aim.

6—The Administration cites the Aswan-dam project as an illustration of why Congress must give at least moral if not legal assurances that our aid will be continued over a period up to ten years. But that project seems to illustrate precisely the opposite. If we commit ourselves to continued aid regardless of what policy the Egyptian Government follows, we lose whatever chance we might otherwise have of exercising any control for peace. Our one hope of retaining control would be to leave the Egyptian Government in constant doubt regarding the next year’s handout.

Not that even this policy is here recommended. We have already thrown away the tremendous sum of \$50 billion in foreign aid since the end of the second world war. Judged by its originally declared objects, never has so much accomplished so little. It is sad to speculate on how much more we could have got for that \$50 billion if we had been permitted to spend most of it at home! ❁

## More about Foreign Aid

April 9, 1956

Last week I cited here the proposed Aswan High Dam in Egypt as an embodiment of the most dubious principles involved in our foreign-aid program. A foretaste of the probable consequences of financing this program by American fiscal agencies is supplied by what has already happened to the Helmand Valley Irrigation Project in Afghanistan. The consequences of this were described by Peggy and Pierre Streit in *The New York Times Sunday Magazine* of March 18. This is the largest American-financed and constructed development in Asia. Conceived as a boon to the people of Afghanistan,

it “has today placed a dangerous strain both on the Afghan economy and on the nation’s morale.”

The project was envisioned as providing a firm water supply, hydroelectric power, flood control, and land development. The U.S. Export-Import Bank dropped loans of \$40 million into it. But we have found no Afghans trained to operate it. The Afghan Government has found its share of the cost “a bitter burden that seriously threatens the Afghan economy.” And there are many who think that the project “may have unwittingly and indirectly contributed to driving Afghanistan into Russian arms.”

The previous history of our foreign-aid programs all over the world, in fact, raises the most serious questions about President Eisenhower’s message asking for a total of \$4.9 billion new foreign-aid appropriations for the new fiscal year:

1—“We cannot now falter in our quest for peace.” We cannot. But this begs the real question at issue, which is whether our foreign-aid programs actually contribute to security and peace. We should not confuse obvious goals with dubious means. The most dangerous aspect of the foreign-aid program is that it creates the illusion we are “doing something,” and diverts attention from the real measures that need to be taken. Do we solve every problem by giving away more of the American taxpayers’ money?

2—“We must continue to stimulate expansion of trade and investment of the free world.” Is a foreign give-away program the sound way to do it?

3—“We have . . . no purpose to change their [other people’s] chosen political, economic, or cultural patterns.” Yet unless most of the governments to which we are giving handouts change from socialistic to free-enterprise policies, our help is worse than useless in bringing permanent improvements in living standards.

4—Asiatic and other nations “are striving to create the standards of living under which their economies can develop.” A worthy goal. Any American who wishes to make a voluntary contribution to it is free to do so. But what is the ethical basis for the notion that our government bureaucrats must force our taxpayers to turn over their hard-earned money to relieve foreign taxpayers and to raise foreign living standards? Why must we have a guilty conscience because we produce more than foreign nations?

5—“Military grant assistance is still necessary in most countries to assist them in maintaining equipment and replacing materiel lost by attrition. . . . Military assistance in Latin America should be continued where needed in order to provide standardized equipment,” etc. Some nations are no doubt unable to manufacture

their own arms. But why must U.S. taxpayers *pay* for the armament of other countries? Some areas, such as Korea and Formosa, undoubtedly need our help. But most countries honestly determined to resist Communist aggression can afford to pay for their own armament. If they can't make it themselves, they can buy it from our government, at cost.

6—The President's message mentioned that in the last two fiscal years there has been a "reduction in unexpended balances" for foreign aid of \$2.5 to \$3 billion. Yet as of Jan. 1 last there was still an unexpended foreign aid balance of \$9 billion. Why didn't the President's message mention this amount also?

7—Is it either wise, or in accordance with the spirit of our Constitution, to ask one Congress to commit its successors to any long-term foreign aid program? ❁

# Foreign Arms Aid Again

April 16, 1956

Many members of Congress are becoming increasingly skeptical about either the need or wisdom of further foreign "economic" aid. But most of them continue unhesitatingly to endorse further "military" aid. Is the difference very real?

The truth is that one kind of aid can easily act as a substitute for the other. When we relieve another nation of the need to pay for its own defense, we in effect give it just that much more funds to spend, say, on economic "welfare" schemes. Failure to recognize this substitutability of foreign aid has led to much mental confusion. "Military" aid is not in fact solely a military question. It is primarily an economic question. The chief question is not, How much defense does Ruritania need? but, Why can't Ruritania afford to pay for its own defense? Why must that burden fall on the American taxpayer?

I present below a table showing the latest fiscal year's armament expenditures of fifteen of our aid beneficiaries stated as a percentage of (1) their total central governmental expenditures and (2) of their gross national product. The record of these countries is compared with our own.

While such international comparisons cannot be precise, they are accurate enough to furnish much instruction. Comparing the overall dollar figures, for example, the United States alone is spending on national defense three times as much *absolutely* as these fifteen nations combined! (Some \$39.7 billion against a total of \$13.4 billion.) We are also spending much more *relatively*—10.2 percent of our gross national

product against an average of 6.6 percent for these fifteen beneficiaries.

The United States, which is giving the defense aid, is spending some 62 percent of its total budget on defense, whereas these thirteen countries receiving aid (if we omit for the moment Formosa and Yugoslavia) are spending on the average only some 26 percent of their total central government budget on defense. This is another way of saying that while we in the United States can afford to spend only some 38 percent of our total budget on nondefense items, these thirteen beneficiaries of arms aid are spending some 74 percent of their total budgets on nondefense items.

## DEFENSE EXPENDITURES

Country	% of Total Government Expenditures	% of Gross National Product
Belgium-Luxembourg	18.3	4.1
China (Formosa)	59.0	12.0
Denmark	20.4	3.3
France	27.6	7.3
Germany	23.9	4.1
Greece	33.2	6.5
Italy	22.0	4.1
Japan	12.0	2.0
Netherlands	22.6	6.0
Norway	26.8	4.5
Portugal	33.6	4.5
Spain	31.6	4.5
Turkey	35.2	5.7
United Kingdom	31.2	8.9
Yugoslavia	77.5	11.6
United States	61.7	10.2

This relationship can hardly be excused on the plea of poverty. Among the countries that are spending relatively most on defense are Greece, Turkey, and Formosa. (It is only fair to add that they are doing this partly because of our defense aid.) The outstanding exception of Yugoslavia is not reassuring. It is frankly a Communist country. We are unlikely to find it on our side when the chips are down.

Is it a good idea for us to rob our own defense, in order to pay for part of the defense of countries that are comparatively indifferent about their defense or do

not take the Communist military threat very seriously? Instead of our contributing nearly \$3 billion to these countries for their defense, why wouldn't it be a good idea simply to suggest to most of them that they transfer part of the total of \$36.1 billion they now spend on non-defense items to their present modest \$13.4 billion for defense? ❁

## Ruining Peter to 'Aid' Paul

April 23, 1956

The new farm bill is a shameless monstrosity. During debate on it the "farm bloc" itself was torn into a dozen haggling special commodity blocs. Wheat-belt congressmen voted for a two-price system for their commodity, but not for corn or cotton. Southern congressmen voted for "parity" supports that discriminated in favor of cotton. And so on around the circle, in a sordid scramble for local votes. Neither party did anything to be proud of. But one thing at least was accomplished by this spectacle. It should stand as a classic illustration to the American people of what inevitably happens when class legislation is either asked for or tolerated; of what inevitably happens whenever the principle of the free market is abandoned for government "economic planning."

The whole notion of government-enforced "parity" prices or income for "agriculture" is a pious fraud. No doubt when it was first proposed it had a certain superficial plausibility. If "agriculture" were not kept prosperous by government subsidy, how could "industry" prosper?

The weaknesses in this idea became evident the moment a serious effort was made to apply it. Why should one section of the population alone (about one eighth of it) get guaranteed prices not granted to every other section? If farmers perform an "essential" service, so do doctors and nurses and teachers, scientists, reporters, and plumbers. Where can one draw the line?

As a matter of fact, as soon as Congress got down to cases, the costliness and impracticability of granting "parity" even to "the farmers" were seen to be so great that discrimination immediately began even as between farmers themselves. Congress decided to guarantee "parity" only for half-a-dozen "basic" commodities. How peculiar the definition of "basic" was, can be seen when we list the so-called basic commodities and the percentage of the total cash receipts from agriculture that each of these commodities represented in 1954: Cotton, 8 percent; wheat, 6.6 percent; corn, 4.6 percent; tobacco, 3.8 percent; rice, 0.8 percent; peanuts, 0.4 percent; total, 24.2 percent.

Altogether, the so-called "basic" commodities account for less than a quarter of the total direct cash receipts of the nation's farmers. On the other hand, cash receipts from livestock and their products constituted in 1954, 55.3 percent of the total. Cattle and calves alone accounted for 16.9 percent of the total, dairy products for 13.7 percent, poultry and poultry products for 10.6 percent, and hogs for 12.1 percent. But the producers of these latter products got no advantage from the price support of the "basic" commodities. On the contrary, this price support for the "basic" commodities increased the feed costs and the price-cost squeeze on the producers of livestock and livestock products.

The biggest joke in the "basic" commodity list is peanuts. They account for only four tenths of 1 percent of total farm cash receipts, as compared with twice as much from oats or barley or potatoes, or with six times as much from soybeans. Politics are fearful and wonderful.

All price-supported commodities together, in fact, account for only 45 percent of gross farm receipts. Support for one commodity producer, as we have just seen, increases the production costs of other farm-commodity producers. The government is forced to order acreage reductions on price-supported commodities to mitigate the surpluses that supports would otherwise create. In 1955, 28 million fewer acres were planted to wheat and cotton than in 1953. But as a result 23 million more acres were planted to oats, barley, soybeans, sorghum grain, and other sorghums. So the previous producers of all these latter crops were just as much injured by this diversion as the producers of the so-called basic crops were "helped."

These are only a few random examples of the distortions of prices, production, and income that are inevitably brought about by government controls. Farmer Peter victimized to "aid" farmer Paul. ❁

## Why Farm Aid Runs Amuck

April 30, 1956

President Eisenhower showed political courage in vetoing the hodgepodge farm bill. He made an excellent analysis of its worst provisions and contradictions. And then, by administrative action, he canceled out half of his own courage and argument.

Mr. Eisenhower correctly pointed out the four main provisions that made the bill unacceptable: "(1) The return to a wartime rigid 90 percent of parity supports for the basic commodities; (2) dual parity



for wheat, corn, cotton, and peanuts; (3) mandatory price supports for feed grains; (4) multiple-price plans for wheat and rice.” The effect of these provisions, he pointed out, would be to “increase the amount of government control and further add to our price-depressing surpluses.”

The provision for dual parity, for example, would result in a permanent double standard of parity for determining price supports. Four crops would receive preferential treatment out of 160 products for which parity prices are figured. And the bill “would hurt livestock farmers more than it would help them—although well over half of farm income is from livestock.”

The President rightly trained his main battery on the effort to go back to rigid wartime price supports at 90 percent of parity. The bill, he pointed out, would not help solve “the real problem—the surpluses which hang over the market and push down farm prices.” On the contrary, it would “set in motion forces designed to produce more of certain crops at a time when we need less of them.” It “would encourage even more surpluses; more surpluses which we cannot use . . . more surpluses which build up faster than we can dispose of them . . . more surpluses which would further depress farm prices in the market.”

But after having made this eloquent analysis, the President himself then announced that in 1956 “we” would set price supports on five of the basic crops—wheat, corn, cotton, rice, and peanuts—“at a level of at least 82½ percent of parity.” He named minimum support levels that would result in a national average of \$2 a bushel for wheat and \$1.50 a bushel for corn. He promised high price supports on cotton and peanuts, and increased price supports on manufacturing milk and butterfat. He has well over \$400 million for that purpose, he declared.

Then he went on to ask for his soil-bank program, nevertheless, with payments that “could add up to as much as an additional \$500 million” to farmers this crop year. The government is already holding the tremendous amount of \$8.9 billion of unsalable farm commodities. This is in itself conclusive evidence that even the present “flexible” scales of 75 to 90 percent of “parity” is far too high. The prices announced by the President would in all probability force the surpluses still higher. Just how low price supports would have to be set now to make it possible to work off surpluses is hard to say. It is instructive to recall at this time that the Agricultural Adjustment Act of 1938 adopted price supports ranging from only 52 to 75 percent of “parity.” No one would have the courage to propose such

moderate supports today. Yet even these price supports led to the accumulation of burdensome surpluses.

The proposed addition of a huge soil-bank subsidy even to prevent government price-support subsidies looks more like an election-year scheme than an economic solution. It would simply add a subsidy *not* to produce to the existing subsidies that encourage overproduction. Once we adopted such a soil-bank program we would probably never be able to get rid of it.

Nothing less seems likely to get us out of a hopeless farm mess today than the complete termination of the whole “parity” fraud. One step in doing this would probably have to be to give back the present farm surpluses in storage to the farmers who produced them, or to sell them back at less than it would cost farmers to produce more. The farm program today is a classic illustration of what inevitably happens when the principle of the free market is abandoned for government “economic planning.” ❁

## Keynesism Crippled by Facts

May 7, 1956

Keynesism—the philosophy of big government spending, deficit financing, and continuous inflation—today dominates the policy of nearly every government in the world. Yet developments in the last few years have destroyed its central prop.

The disciples of Keynes disagree among themselves about what the chief contribution of the master really was. Yet most of them would probably agree with his leading American disciple, Prof. Alvin H. Hansen, that “Keynes’s most notable contribution . . . was his consumption function.” In 1936 in his famous *General Theory of Employment, Interest, and Money*, Keynes declared that there is a “fundamental psychological law, upon which we are entitled to depend with great confidence . . . that men are disposed, as a rule and on the average, to increase their consumption as their income increases, but not by as much as the increase in their income.” He went on to call this “law,” rather pretentiously, the consumption “function.” Keynes’s great “discovery,” in short, was that if we knew what national income was going to be we could tell from a curve or a mathematical formula what consumption was going to be.

Of course, from time immemorial it has been a truism that most families spend most of their income. Official statistics for the last eight years, for example, show that on the average in that period Americans spent about 93 percent of their annual income on



personal consumption and save only about 7 percent of it. So if you knew what personal disposable income were going to be next year, it would be hard to make too great a percentage error in predicting what consumption expenditures were going to be. It would be much easier, however, to make a substantial percentage error in predicting what saving was going to be, because saving is comparatively such a small figure.

I append at the bottom of this article a table showing (in billions of dollars) the nation's disposable personal income for the last twelve years, the amount of personal savings, and saving as a percentage of disposable income. Now Keynes's great "law" is that consumption does not increase in proportion to income, and therefore savings increase proportionately more than income increases. The events of 1955 were in themselves a crushing contradiction of this "law". Disposable income *increased* by \$14.6 billion, but savings *fell* by \$1.2 billion. The total percentage of saving to disposable income fell from 7.2 to 6.3. The same thing happened between 1953 and 1954. Disposable income went *up*, \$4.4 billion, savings *down*, \$1.5 billion. Out of the last eleven years, in sum, Keynes's "law" worked in four and was reversed in seven.

Year	Income	Savings	Savings as % of Income
1944	\$146.8	\$36.9	25.2
1945	150.4	28.7	19.1
1946	159.2	12.6	7.9
1947	169.0	4.0	2.4
1948	187.6	10.0	5.3
1949	188.2	7.6	4.0
1950	206.1	12.1	5.9
1951	226.1	17.7	7.8
1952	236.7	18.4	7.8
1953	250.4	19.8	7.9
1954	254.8	18.3	7.2
1955	269.4	17.1	6.3

I may be accused of unfairness for including the enormous savings in 1944 and showing their decline in 1945, 1946, and 1947 in spite of substantial rises in disposable income in each year. It will be said that savings were heavy in 1944 and 1945 because they were war years and consumer goods were not available. Precisely. But this only underlines the fact that Keynes's "law" is no law, and that the relationship of spending and saving does not depend solely on total income changes but

on innumerable factors. Savings may depend less on what people earn today than on what they expect to earn tomorrow. Their spending this year may depend to a large extent on whether they expect the prices of the things they want to buy to be higher or lower next year. People may buy on impulse, or refrain from loss of confidence. In short, experience and statistics fail to support the main Keynesian tenet; and the Keynesian logic is a rope of sand. ☼

## You, Too, Can Forecast

May 14, 1956

In the issue of Jan. 30, *Newsweek* carried an amusing and instructive article on how far wrong the economic forecasters went at the end of 1954 in predicting what was going to happen in 1955. The moral was that forecasting is not a science.

This is completely true. This column, in fact, has gone farther, and has contended (see *Newsweek*, Jan. 9, 1956; Jan. 3, 1955; Nov. 22, 1948) that not only is economic forecasting not an exact science *yet*, but from the very nature of its subject can never be. Ludwig von Mises, in an excellent article in *National Review* of April 4 last, concisely explained why this is so. Economics, because it deals primarily with human choices, decisions, and actions, cannot be a "quantitative" science. Statistics have a limited value because they necessarily refer to the past only. Knowledge of the future can never be firmly assured by charts or curves "extrapolating" some recent trend. And it is merely of negative help to the speculator or businessman even to guess the future correctly unless his correct guess is shared only by a few. For in the economic field expectations concerning the future themselves help to determine that future.

Yet when all this has been said, all of us *must* forecast. For we are daily forced to act on *some* expectation regarding the future. Therefore, a recent carefully compiled and sensibly reasoned study of 76 pages, "Forecasting in Industry," published by the National Industrial Conference Board, can be read with profit, as much for the negative as for the positive lessons that it has to teach.

As the study declares in a foreword: "Forecasting is a rudimentary and essential element of business. An appraisal of future prospects, whether based on study, judgment or hunch, is inherent to financial planning, appropriating capital, timing purchases, setting production and inventory levels, directing sales . . ."

The study then goes on to discuss the various methods of forecasting actually used in business. Among

these are: (1) The “Jury of Executive Opinion Method.” This is merely a process of combining and averaging the views of top executives. It has its merits, though “in some companies the process amounts to little more than group guessing.” (2) The “Sales Force Composite Method.” This is more of a “grass roots” approach, but it also has its disadvantages, one of which is that salesmen often tend to be either too optimistic or too pessimistic according to immediate conditions. (3) Next we come to the use of various statistical methods, including correlation analysis, trend and cycle projections, and mathematical formulas. These have the advantage of being “measurable” and “objective,” and of “quantifying” their conclusions. But they are full of traps for the unskilled and unwary.

Take correlation. As the Conference Board’s study admits: “Good correlations occasionally result from coincidence rather than from logical cause and effect or from any direct relation between the two factors. . . . The great disadvantage of correlation analysis is the danger of relying too heavily upon the statistical method and a tendency when using it to neglect independent appraisal of future events.” But isn’t this a way of admitting that it isn’t so much statistics or mathematical relationships that enable us to forecast the economic future as sound *prior* reasoning that leads us to select the right statistics?

An instructive case in point is the American Radiator Co. It discovered years ago that there was “a good correlation between the F.W. Dodge figures on residential building contracts awarded and sales of its plumbing products.” It found that residential contracts led its sales by about four months. But, as homes always need plumbing, it was obviously common sense, and a prior knowledge of cause and effect, that led company officials to *look* for this correlation. To sum up, statistics may often be helpful, but may also be treacherous. They can never take the place of shrewd judgment, good sense—and a large measure of good luck.

And now that you know all the secrets, you too can forecast. ❁

## Cheap Money and Inflation

May 21, 1956

The steady shower of criticism that has beaten upon the Federal Reserve authorities since they increased prevailing discount rates to 2¾ percent in April reveals the strength and extent of the inflationary sentiment that has developed in this country.

The criticism has come both from within and outside the Administration. Treasury Secretary Humphrey and Dr. Arthur Burns, the President’s chief economic adviser, were reported to be opposed to the increase. Commerce Secretary Weeks and Labor Secretary Mitchell have publicly questioned its wisdom or necessity at this time. State and city officials complain that it will raise the cost of their borrowing. Builders and other businessmen are grumbling. And of course inflationists are raising cries of alarm.

President Eisenhower, however, in two press conferences, has stoutly maintained the political independence of the Federal Reserve authorities. It is good to have this independence reaffirmed. But it is perhaps even more important to point out that the decision in favor of monetary restraint is the right one, and the only safe one at the present time.

William McChesney Martin, Jr., the chairman of the Federal Reserve Board, has made an excellent defense of this decision. “We fight inflation,” he declares, “partly because it is the forerunner of deflation. . . . If I thought inflation would create jobs and prosperity, I might be for it. But I am convinced that, apart from transitory effects, the result of inflation is destruction of jobs and prosperity.”

It is also heartening to report that two of the largest banks in New York, the Guaranty Trust Co. and the First National City Bank, have made admirable defenses of the Reserve banks’ increase in interest rates in their May letters. The Guaranty Trust points out that much has been made of the fact that the latest advance carried the prevailing discount rate to the highest level in 23 years. But what most commentators do not mention, the Guaranty Survey goes on to point out, is that the present rates, viewed in a longer perspective, “are not high but low. Not until 1930 did any Federal Reserve discount rate go below 3 percent. . . . Only by comparison with conditions during and since the depression are current rates high. . . . A rise in money rates usually indicates an increasing utilization of available credit resources and a corresponding need for restraint. Under such conditions, a refusal to follow the market would amount to positive intervention on the side of easy money, overexpansion of credit, and inflation.”

Both the Guaranty and National City letters then go on to point out the numerous indices of present-day inflation. “Excessive borrowing, pressure at bottlenecks, rising wages and prices,” declares the National City, “are all evidence that people are trying to get more out of the economic organization than it can presently produce. This is the general situation, despite the soft spots, and it is the essence of the inflationary trend.”

In fact, the Keynesian game of “cheap money forever” shows signs of playing itself out. Cheap money and inflation can work their apparent miracles only as long as creditors do not expect *further* inflation. As soon as they do expect it, they demand much higher interest rates to compensate for real capital losses. Higher interest rates are now worldwide. The Bank of England’s discount rate is now 5½ percent. The chief remedy required here at home is to restore confidence in the dollar.

The case for monetary restraint was summed up impressively in the President’s latest annual economic report: “Success in preventing depression depends in large part upon a willingness to avoid the excesses that can so easily develop during prosperity. . . . If credit on easy terms were available to everyone at a time when the economy is already working close to capacity, the consequence would be a scramble for limited resources and a cumulative bidding up of prices. . . . A government that sought to prolong prosperity by such devices would be taking a road that all too often has ended in disaster.” ❁

## Built-In Inflation

May 28, 1956

In its last annual report the U.S. Steel Corp. described what has been going on in the United States in recent years (and for that matter in nearly every country in the world) under the illuminating phrase, “institutionalized inflation.”

The U.S. Steel report began by citing what appears to be a “permanent and alarming peacetime trend of cost and price inflation.” Its employee cost per employee hour, for example, between 1940 and 1955, showed an increase averaging 8 percent a year compounded. This, and an even greater percentage rise in other costs, has forced the steel industry to raise steel prices and “thereby pass on to buyers of steel part of the underlying cost of inflation.” Prices of steel-mill products, as a result, increased 119 percent between 1940 and 1955.

### THE TWO BASIC ROOTS

The company then went on to describe the “two basic roots” of this “inflationary tendency”: “The first one is the institution of industrywide labor unions, headed by leaders who, with power to bring about industrywide strikes, seek always to outdo each other in elevating employment costs in their respective industries. The legislative and social framework within which they function compels them to compete in elevating this basic cost.

“The other root is the government’s ‘full employment’ policy under which the money supply must be inflated fast enough to accommodate the inflating employment cost, lest that mounting cost bring about its natural result of pricing some people out of their jobs, even though only temporarily. It takes ever more dollars to cover ever-rising costs and prices if industry’s full output is to be purchased. The money supply—people’s bank deposits subject to check plus their pocket currency—was in 1955, on a per capita basis, 2.7 times what it was in 1940. This is equivalent to 6.8 percent per annum compounded.

“The abuse of labor monopoly privilege and the monetary policy that transfers to the public in higher prices the penalty of that abuse appear to be the main elements of institutionalized inflation. It would be helpful in this regard if those responsible for determining wage costs and fiscal policies were constantly aware of the inflationary potentials of their decisions.”

This is an excellent compact description of what has been happening. But it is important to be clear concerning the precise chain of cause and effect, and not to confound the two. The direct cause of inflation is always an increase in the quantity (as well as a depreciation in the quality) of money and bank credit. This is almost wholly controllable by governmental policy. At the end of 1939 our total supply of bank deposits and currency outside of banks was \$64.7 billion. At the end of 1952 it was \$200.4 billion; at the end of 1953, \$205.7 billion; at the end of 1954, \$214.8 billion; and at the end of 1955, \$220.2 billion.

This is the result of governmental inflation—a combination of continuous deficit spending with artificial low-interest rates which overstimulate private as well as public borrowing. If an individual labor union, or labor generally, were to force up its wage rate level beyond the equilibrium point, the result would not be further inflation, but unemployment. Yet the government does not dare to let this natural consequence of excessive wage rates take place. It constantly finances this wage increase by deficit spending and cheap money policies. Under the Taft-Hartley and other laws it builds up industrywide unions, legally forces employers to “bargain” with these monopolies, and makes resistance to continuous wage increases practically impossible.

### POLITICAL PRESSURES

Thus we have wage inflation financed and made possible by monetary inflation. True, our Federal Reserve authorities are now trying to effect some measure of restraint. But practically all the bipartisan political pressures in Washington—wage boosting laws, huge new spending schemes for foreign aid, roads, schools,



farm subsidies, social-security expansion, government-guaranteed mortgages, and government pressures for further strengthening of industrywide unions—are on the side of still more institutionalized inflation. ❁

## Foreign-Aid Mania

June 4, 1956

One of the most baffling developments of the last decade has been the persistence and growth in Washington of the mania for giving away billions of the American taxpayers' money to foreign governments. The pressure for ever-greater farm aid, old-age assistance, grandiose road-building programs, home-mortgage guarantees, and a score of other such projects is not difficult to understand politically. The pressure groups who want and get this aid have votes. But foreigners don't vote here. Why is the pressure for foreign aid in Washington so persistent?

Part of the answer, no doubt, lies in an established bureaucracy. Once a bureaucracy of hundreds or thousands of people is built up to exercise any function whatever, its tendency is to keep pushing for the continuance or expansion of that function, regardless of whether changed conditions may have made the original reasons for it no longer valid.

### AID MEANS HIGH TAXES

This bureaucratic pressure is not in itself a complete answer to the puzzle. And certainly the answer is not that the amounts involved are negligible. We have already turned over to foreign governments since the end of the second world war the enormous sum of more than \$50 billion. The government now wishes to spend \$4.4 billion on foreign aid in the next fiscal year alone. It wishes Congress to appropriate \$4.9 billion. At any time prior to the last fifteen years, this would have been thought a staggering sum. It represents four times the entire amount spent for our own national defense in the fiscal year 1939.

But perhaps it is more meaningful to make a comparison in terms of present taxes. It has been estimated that if the top progressive income-tax rate stopped at 50 percent (instead of going on to 91 percent as at present) the revenue loss would be only \$1.2 billion. On various estimates, in fact, if progression above the basic rate of 20 percent were totally abolished, the annual revenue yield would be only \$4.7 to \$5.8 billion less than now. But this approximates what the government is asking for foreign aid alone in the next fiscal year. In any case, anyone who is now paying a top income-tax rate of more than 22 percent can consider that the excess all

goes for foreign aid. It need hardly be pointed out that if the top rate stopped at 22 percent, the result would be to give an enormous impetus at home to incentive, saving and investment, production, and jobs.

As former hopes of the benefits from foreign aid have been successively disappointed, the rationalizations for its continuance keep constantly changing. They become increasingly rhetorical and vague. We are now being told by "experts" that we are placing too much emphasis on military instead of "economic" aid; that our foreign giveaway should be given away without conditions; and that we should not try to foster free enterprise abroad or even to win friends with our aid. If such arguments are accepted, it becomes difficult to see what excuse for foreign aid remains. As *National Review* has put it: "A government has no right to dispose of the property of its citizens, except as their prudent, responsible steward and in their palpable interest. A government has no obligation, moral or political, to give aid to other governments." In fact, the only foreign aid Congress is justified in giving at the expense of the American taxpayers is military aid or aid with a definite *quid pro quo*.

### FOR PRIVATE LOANS

The blunt truth is that the only "economic" foreign aid that is likely to be beneficial either to the receiver or the giver is that in the form of private trade or private loans and investments. If foreign governments could no longer get these easy handouts from our government, they would be forced to turn for capital to private sources, either at home or abroad. In that case they would be obliged to move toward free enterprise. They would have to give real assurances against socialization or expropriation. Such reforms are necessary in any case for any permanent or rapid economic development. The "underdeveloped" countries have remained underdeveloped chiefly because of their own hostility to the profit-seeking system. ❁

## Transitory Magic

June 11, 1956

The storm of criticism that has beaten upon the Federal Reserve authorities since they made a small increase in prevailing discount rates to 2¾ percent in April, and the indications that as a result those authorities are now planning to make money "easier," raise some fundamental questions. One of them is whether constant new doses of easy money and inflation can really keep a "full employment" boom going indefinitely.



It is the present prevailing belief that they can. The most direct challenge to this popular belief from any official source has come from the chairman of the Federal Reserve Board himself, William McChesney Martin, Jr., in a statement quoted in this column of May 21: "We fight inflation partly because it is the forerunner of deflation. . . . If I thought inflation would create jobs and prosperity, I might be for it. But I am convinced that, apart from transitory effects, the result of inflation is the destruction of jobs and prosperity."

### PRICE-WAGE RACE

It is hard to get people to realize this today. Money-and-credit inflation has seemed to work its "full-employment" magic in the United States for the last fifteen years. Nevertheless, inflation can bring "full employment" only under special conditions, which are unlikely to prevail for more than a limited time.

The first of these special conditions is that prices must rise faster than wage costs in order to restore or increase profit margins. A second condition is that businessmen must be convinced that prices will continue to keep ahead of wage rates and other costs, otherwise business will not embark upon ambitious expansion plans. A third condition is that lenders, on their side, must be convinced that the inflation has come to an end. If they also believe that inflation will continue into the future, they will refuse to lend except at high rates that compensate for the expected depreciation of their money.

Whenever any one of these three major conditions ceases to exist, monetary inflation will cease to create "full employment." Yet for these three conditions to exist, both workers and lenders must be the victims of what the economist Irving Fisher called the "money illusion." The workers must fail to recognize that their real wage rates are going down (because prices are going up faster), and creditors must fail to recognize that they will lose real purchasing power as a result of their loans.

### THE MONEY ILLUSION

An instructive table published in the May letter of the First National City Bank of New York showed that those who bought U.S. Savings Bonds at any time between 1935 and 1946, and held them for a ten-year period, suffered an actual loss from their investment. The interest received has not been enough to compensate for income-tax payable and the "inflation tax" levied in the form of a shrinkage in the buying power of the dollar. This condition continues. In the week ended, May 22 last, for example, wholesale commodity prices showed an average increase of more than 4 percent for the twelve-month period. This means that a businessman who lent out his money at 4 percent or less

twelve months before got practically no real interest at all. When lenders come to expect any such annual rate of price increase in the future, they will insist on adding it as a "price premium" to what the rate of interest would otherwise be. That is why money rates tend to soar in the late stage of an inflation.

An inflation brings "full employment," in short, only as long as prices are rising faster than wage or interest rates, or keeping ahead of them. As soon as wage costs start to race ahead of prices, as they now show signs of doing, then, whether or not there is more inflation, the result will inevitably be unemployment.

Inflation always brings about great strains and distortions in the economy. This is why Chairman Martin of the Federal Reserve Board is correct when he declares that the ultimate result of inflation is "destruction of jobs and prosperity." The longer inflation is continued, the greater the correction that must ultimately be made. It is much better to permit a relatively mild adjustment now, than to force a more violent correction later. ❁

## Political Farm Law

June 18, 1956

The new farm law is primarily a political document. It will not solve our self-created farm problem. It will entangle the government more hopelessly than ever in farm controls. It will greatly increase the already heavy burden upon the taxpayer. True, the new law is better than the bill the President vetoed; but it threatens in the long run to do even more harm than the law it displaced.

Mr. Eisenhower's own objections to the new measure when he signed it were enough to condemn it. He rightly deplored the "inflexible" requirement that the government must dispose of 5 million bales of its cotton surplus abroad at a price no higher than 25 or 26 cents a pound. This is not only much below the original government acquisition cost of 32 cents a pound or more; it is below the present domestic level of about 35 cents a pound, and below the 1956 support rate of 31 cents a pound.

### TWO-PRICE SYSTEM

This disposal requirement threatens not only to get us into serious difficulties with other cotton-raising countries, but it means that foreign textile firms will be able to get their raw American cotton at much lower prices than our own textile firms will have to pay. This will place the American textile industry at a disadvantage both in the home and in the foreign market. If,

as is being suggested, the government subsidizes the American textile exporter, it will mean that the taxpayers must subsidize the cotton manufacturer to offset their subsidy to the cotton grower! The new bill in effect sets up a two-price system for cotton without explicitly calling it that. It does explicitly call for a two-price plan for rice.

But Mr. Eisenhower thinks that the “advantages” of the new law “outweigh its harmful provisions” because “the heart of the bill is the soil bank.” This “will check current additions to our price-depressing, market-destroying surplus stocks of farm products.” It remains to be seen whether the soil bank will in fact do this.

If the soil bank had been made a complete substitute for a price-support program something might have been said in favor of it. But it is an *addition* to the price-support program. Price supports, in fact, are even being raised. This means that the government will first pay the farmer a subsidy to encourage him to *increase* his crop production, and then pay him still another subsidy to encourage him to *decrease* his crop production. In addition to getting price supports for what he raises, the farmer will be paid 90 cents a bushel for the corn he doesn’t raise, 15 cents a pound for the cotton he doesn’t raise, and \$1.20 a bushel for the wheat he doesn’t raise.

### CONTRADICTIONS

The soil bank, it is estimated, will pay farmers \$1,250,000,000 a year above present subsidies for taking crop acreage out of production and putting it into cover crops or trees. An additional \$500 million of funds will be authorized to remove perishable farm items from the market to prevent price declines. Once more, in sum, everything is to be solved at the expense of the general taxpayer.

The soil bank does have one advantage over the previous system. Up to now, when his acreage was restricted on one crop, the farmer usually planted this acreage to other crops on which there were no restrictions. As these substitute crops were usually feed grains, the result was a stimulus to livestock production, which helped to depress the prices of cattle and hogs. But this evil could have been cured simply by removing existing price supports and acreage restrictions. The government’s accumulated surpluses could have been got rid of, with greater advantage all-around, by offering them below world market prices to the American farmer himself in proportion to his previous production, leaving it to him to dispose of them at whatever profit he could obtain.

Now that we have the so-called soil bank, it is impossible to see politically how we will ever get rid of it. The present farm-control fiasco should stand

as a classic illustration of how government economic “planning” leads to ever-wider and contradictory interventions in the vain hope of correcting the evil consequences of previous intervention. ☼

## The Great Swindle

June 25, 1956

We live in the Age of Inflation. It has become a fixed idea among governments that their paramount economic aim must be to maintain “full employment,” and that full employment can be maintained only by deficit financing, artificially cheap money, or direct recourse to the printing press.

Once under way, inflation sets in motion powerful special interests which demand its continuance. For it benefits some groups of the population at the expense of all the rest. Inflation is a tax—the cruelest and most wanton of all taxes. Under it, all creditors are systematically swindled.

### CYNICAL DEFENSE

“He that would hang his dog,” says an old proverb, “gives out first that he is mad.” He that would swindle a creditor must first give him a bad name. The late Lord Keynes did this by calling him the “rentier.” He implied that the rentier was simply an idle plutocrat who lived on unearned interest at the expense of the struggling workers. In his *General Theory* (page 376) Keynes spoke of “the euthanasia of the rentier, and, consequently, the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital. Interest today rewards no genuine sacrifice.”

But who in the modern world *are* the creditors, the “rentiers”? They include, in addition to the holders of mortgages and corporate bonds, the thrifty, the small people who put their money in savings deposits or life-insurance policies, and all the owners of government bonds, who were induced to take these bonds for patriotic reasons. And who are the debtors who are being relieved of the allegedly dreadful burden of having to pay interest and repay capital in currency units of the same value as those they borrowed? They include the big corporations, the big holders of common stocks, and the speculators who have learned how and when to jump in and out and exploit the value of a depreciating currency.

I append a table compiled by Franz Pick for his forthcoming 1956 edition of *Pick’s Currency Yearbook*. This shows the depreciation of 53 currencies in the ten years from 1946 to 1955, as measured by each

government's own cost-of-living index. This table, it will be noted, shows that the U.S. dollar, the world's monetary pivot, shrank 17 percent\* in buying power over the past decade. The British pound sterling lost 35 percent; the French franc 66 percent. The currency units of Chile, Paraguay, Bolivia, and Korea had their purchasing power practically wiped out.

Some of the countries whose currencies suffered worst, such as Formosa and Korea, were struggling with special war or defense problems. But this was obviously not true in Chile, Paraguay, or Bolivia. The truth is that this shocking swindle by governments of their own citizens was brought about in most cases by deliberate monetary or credit inflation. And it was all done under the pious pretense that inflation is a sort of calamity visited on a country by malevolent outside forces, which the politicians and monetary managers profess to be incessantly combating.

#### CURRENCY UNITS

Loss of purchasing  
power, 1946-55  
Percent

Portuguese	0
Dominican	2
Egyptian	2
Haitian	3
Indian	10
Pakistan	10
Ceylon	11
Lebanese	16
Belgian	19
Swiss	19
German	22
Honduran	24
Irish	24
Italian	24
Guatemalan	25
U.S.*	27
Costa Rican	27
Danish	27
Ecuadorian	27
Canadian	28
Netherlands	29
Norwegian	29
Iranian	30
Venezuelan	30
S. African	31

Loss of purchasing  
power, 1946-55  
Percent

Spanish	31
Swedish	31
El Salvador	32
Turkish	32
Hong Kong	33
Thailand	33
Malayan	34
New Zealand	34
British	35
Colombian	46
Uruguayan	46
Iceland	48
Mexican	48
Nicaraguan	49
Australian	50
Finnish	52
Austrian	54
Peruvian	59
Brazilian	60
Greek	61
French	66
Japanese	67
Israel	68
Indonesian	69
New Taiwan	85
Chilean	91
Paraguayan	91
Bolivian	95
Korean	99

[\*This entry was originally published and ranked as 17, but was corrected to 27 in the article of July 23, 1956. —Ed.] ⚙

## Cut-Rate Currencies

July 2, 1956

This year more than a million Americans will travel abroad, and probably spend about \$2 billion doing so. Most of them will take only dollars with them, in the form of travelers' checks, and buy their foreign currencies in each country as they need them. In this way they will needlessly waste hundreds of millions of dollars. Most foreign currencies can be bought right here

before leaving, and at substantial reductions below the “official” parity rate.

The average American traveler either does not know that these bargains can be obtained here, or mistakenly believes that they represent a black-market transaction. He still does not realize the extent to which foreign-currency controls have been relaxed in recent years.

There are limits, of course, to what can legitimately be done. Great Britain, for example, still makes it illegal to bring more than £10 into that country. But France, Germany, Austria, Belgium, Ireland, India, and Italy impose no limit on the amount of their own currency that may be taken in by the traveler. Spain imposes the high limit of 10,000 pesetas.

### POSSIBLE SAVINGS

To give an idea of some of the savings that might be effected at recent quotations, French francs at the official rate are 350 to the dollar; they can be bought here (legally) at 390 to the dollar. The official rate for Turkish lire is 2.80 to the dollar; they can be bought here ten for a dollar. At the moment of writing there is a terrific “bargain” in Bolivia’s boliviano. The official parity is 190 to the dollar; it can be bought here for 5,500 to the dollar. The foreign-exchange dealers in New York who specialize in these sales wonder why an American tourist will figure how to save a few dollars on his airplane tickets or luggage, or travel tourist-class rather than better, and then throw away \$100 or \$1,000 by failing to buy his foreign currencies here before he leaves.

Some banks sell foreign currencies, but such business is done in the main by foreign-currency dealers. Among the larger dealers are Perera Co., Deak & Co., William Holzman & Co., and Lionel Perera, Manfra & Brookes.

The huge discrepancy that has developed between “official” and market rates of foreign currencies is the result of foreign-exchange controls built up during and since the second world war. Foreign-exchange control is a totalitarian device. A government seizes from its own exporters part of the dollars (or other “hard” currencies) they would otherwise have earned, thus discouraging exports from that country. The government then encourages excessive imports into its own country by selling these seized foreign currencies at bargain prices. It thus creates an “unfavorable balance of trade”—and blames its own exporters and its own citizens for this result. Exchange control also enables a government to conceal from its own people the real extent of the depreciation of their currency.

### THE REAL SOLUTION

A few weeks ago Dr. Ludwig Erhard, West Germany’s Minister of Economics, once more spoke out against the consequences of this system. He declared that only three currencies in Western Europe—the West German mark, the Belgian franc, and the Swiss franc—are valued correctly in terms of the U.S. dollar. The rest are priced too high and ought to be “readjusted.” As a result of false official valuations the world no longer has a true international price system or free convertibility of currencies.

Although Dr. Erhard did not go this far, the real remedy is not another official “readjustment” of currency values; it is to follow the example of Canada, and let each currency be bought and sold at its daily market value. It would thus become fully convertible. It would then be up to each government to stabilize its currency, not by imposing coercions on its own citizens, but by taking the measures necessary to maintain confidence in its currency both at home and abroad. This would mean an end to deficit financing, to cheap-money policies, and to any further resort to the printing press. This is the first necessary transitional step. Ultimately, of course, there will be no lasting stability of domestic or international currency values until the world returns to the international gold standard.

## Money and Goods

July 9, 1956

Among the popular ideas which make the inflation of our era so hard to combat is the belief that the supply of money ought to be constantly increased “in order to keep pace with the increase in the supply of goods.”

This idea, on analysis, turns out to be extremely foggy. How does one equate the supply of money with the supply of goods? How can we measure, for instance, the increase in the total supply of goods and services? By tonnages? Do we add a ton of gold watches to a ton of sand?

We can measure the total supply of goods and services, it is commonly assumed, by values. But all values are expressed in terms of money. If we assume that in any period the supply of goods and services remains unchanged, while the supply of money doubles, then the money value of these goods and services may approximately double. But if we find that the total monetary value of goods and services has doubled during a given period, how can we tell (except by *a priori* assumption) how much of this is due to an increase of production, and how much to an increase in the money supply? And as the money price (i.e., the “value”) of



each good is constantly changing in relation to all the rest, how can we measure with exactness the increase of "physical production" in the aggregate?

### 'EXPERTS' DISAGREE

Yet there are economists who not only think that they can answer such questions, but that they can answer them with great precision. Dr. Sumner H. Slichter of Harvard has recommended a  $2\frac{1}{2}$  percent annual increase in the money supply in order to counterbalance the price-depressing, effect of an assumed annual  $2\frac{1}{2}$  percent increase in productivity. Dean Arthur Upgren of the Tuck School of Business Administration at Dartmouth wrote last year: "Businessmen, bankers, and economists estimate that the nation requires a money supply growth of 4 or 5 percent a year." He arrived at this remarkable figure by adding "a  $1\frac{1}{2}$  percent a year population growth, a  $2\frac{1}{2}$  percent yearly gain in productivity, and a gain of 1 percent in the money supply needed to service the more specialized industries." This looks like counting the same thing two or three times over. In any case, as Lawrence Fertig pointed out in an article in *The New York World-Telegram* (Oct. 24, 1955), there can be nothing scientific about calculations that vary as widely as this.

Yet a lot of people have come to believe sincerely that unless the supply of money can be increased "proportionately" to the supply of goods and services there will not only be a decline in prices, but that this will bring on "deflation" and depression. This idea will not stand analysis.

### PROFIT MARGINS

If the quantity and quality of money remained fixed, and per capita industrial and agricultural productivity showed a constant tendency to rise, there would, it is true, be a tendency for money prices to fall. But it does not at all follow that this would bring about more net unemployment or a depression. For money prices would be falling because real (and money) costs of production were falling. Profit margins would not necessarily be threatened. Total demand would still be sufficient to buy total output at falling prices.

The incentive and guide to production is *relative* profit margins. Relative profit margins depend, not on the absolute level of prices, but on the relationship of different prices to each other and of costs of production (factor prices) to prices of finished goods. An outstanding example of prosperity with falling prices occurred between 1925 and 1929, when full industrial activity was maintained with an average drop in wholesale prices of more than 2 percent a year.

The idea that the supply of money must be constantly increased to keep pace with an increased supply

of goods and services has led to absence of concern in the face of a constant increase in the money supply in the last six years. From the end of 1949 to the end of 1955 the supply of bank deposits and currency increased \$47 billion, or 27 percent. And since the end of 1949 average wholesale prices have increased more than 15 percent, in spite of an increase in the industrial production index of 46 percent. ☼

## Steel Strike Lessons

July 16, 1956

Once more an industrywide union has demonstrated that it can halt a great industry and cripple the nation's economic life unless its demands are met. Once more union leaders have shown that they will not hesitate to abuse this enormous private economic power.

Was the position of the steelworkers so intolerable that their leaders had no choice? On the contrary, the steelworkers were receiving the highest pay they ever received in history. Speaking for the steel industry, Adm. Ben Moreell pointed out that the steelworker's wages alone averaged more than \$5,200 a year, and that his average hourly earnings were already 52 cents above those in all manufacturing industries.

On top of this, the steel industry offered its workers wage increases and other benefits which, it estimates, would have increased the companies' employment costs by an average of more than 17 cents an hour in the first year and by a total of 65 cents an hour in the fifth year. According to Admiral Moreell, "the total offer was the largest single package ever advanced by the companies in the history of the steel industry."

This offer was not only turned down cold by David J. McDonald, the \$40,000-a-year president of the industrywide steel union, but treated with derision and contempt. It was "picayune." "The titans of industry have labored," as he so elegantly put it, "and brought forth a louse."

### EXCESSIVE POWER

Upon what meat do such union leaders feed that they have grown so arrogant and powerful? Up to the moment of writing, the Eisenhower Administration has kept "hands off" the present dispute. That is to say, it has neither threatened to seize the steel companies unless they capitulate, in emulation of Truman, nor has it sought an 80-day no-strike injunction under the Taft-Hartley Act. Yet the union leaders' power has been in large part brought about by Federal interference under the routine operation of the Wagner-Taft-Hartley Act.

That act forces the employer to “bargain in good faith” with the representatives of a specified union no matter how unreasonable their demands. It is this law that has built up industrywide unions. Through interpretations by the National Labor Relations Board and by the courts, it even permits the strikers to use physical intimidation to prevent others from working. As the president of the steel union’s Local 1843 candidly put it: “The picket lines [around Jones & Laughlin] are being established to prevent anyone from going into the plant.” It has been years, in fact, since the steel companies have dared make any attempt to operate in the face of a strike.

### STRIKES VS. WAGES

Labor law is now what it is because of the deep-seated popular fallacy that strikes and other coercive actions by nationwide unions can raise the general level of real wages. But a successful strike by the steelworkers will further raise the price to consumers of all products made with steel. It will thus reduce the real buying power of the wages of all other workers. Further gains by the unions already most powerful and best paid can only be at the expense of the great body of workers that are paid less. A higher price for steel may cause unemployment among steel and other workers. If an attempt is made by Federal officials to counter this by further expansion of money and credit, the result will be another round of inflation. The money-wage gains will be wiped out by further rotting of the dollar.

And what of the steelworkers themselves? Suppose they do gain a further increase, but only after a prolonged strike? The Westinghouse Electric strike, which lasted 156 days and was settled in March, may serve as an illustration. At the end the workers got increases ranging from 5 to 17 cents an hour. But *The Wall Street Journal* calculated at the time that even if the benefits claimed add up to as much as 20 cents an hour increase, it will take Westinghouse workers 250 full-time weeks, or nearly five years, to earn back the \$100 million they lost in wages. They will be then just where they would have been if there had been no increase at all and no strike. ❀

## Profits Mean Payrolls

July 23, 1956

At the time they went on strike the steelworkers were already receiving the highest wages in history. They were averaging \$103.25 a week in January compared with an average of \$78.55 for workers in all manufacturing industries. As compared with 1940, whereas

living costs had increased 91 percent, the steelworkers’ weekly earnings had increased 230 percent. On top of this the industry offered the union the “largest single package” of wage increases and fringe benefits it had ever proposed.

Yet the union leaders disdainfully turned the offer down, preferring, instead, the disruption and risks of a strike. One of the major reasons they gave for this course was that the steel industry was making large profits.

### MOVING TOGETHER

Now it is true that the bookkeeping profits of the steel industry in 1955 were comparatively high. But it by no means follows that these profits were at the expense of wages. The historical record, both in the steel industry and in industry in general, shows: (1) Total wages paid are nearly always several times total net profits. (This means that the workers collectively have an even greater material stake in the security and prosperity of the corporations than the stockholders have.) (2) Overall profits and wages do not vary inversely, but rise and fall *together*. In the six years from 1950 through 1955, for example, total wages paid by the steel industry were almost exactly three times as great as its profits after taxes. In 1950, when the industry’s profits were only \$767,000,000, it paid total wages of \$1,786,000,000. In 1955, when its profits had risen to \$1,098,000,000, it paid wages of \$2,665,000,000.

Even more impressive evidence of the normal correspondence of wages and profits emerges when we select a longer range of years and compare total wage payments in the U.S. with total corporate profits (both before and after taxes). This does not, of course, show the comparison of *total* profits with total wages, because wages are paid by partnerships and individual employers as well as by corporations. But a comparison of corporate profits with total wages nonetheless does show clearly that when profits are high wages are high, and that when profits are lowest wages are lowest. The following figures are all in billions of dollars:

### CORPORATE PROFITS

Year	Before taxes	After taxes	Labor income
1929	\$ 9.6	\$ 8.3	\$ 51.0
1931	- .8	-1.3	39.6
1932	- 3.0	-3.4	30.9
1939	6.4	5.0	46.6
1949	26.2	15.8	137.4
1950	40.0	22.1	150.3
1951	41.2	18.7	175.6

Year	Before taxes	After taxes	Labor income
1952	35.9	16.1	190.5
1953	38.3	17.0	204.6
1954	34.0	17.0	202.8
1955	43.8	21.8	215.5

It will be noticed that in the years when industry did worst (as in 1931 and 1932, when net profits were less than zero) labor did worst. When profits were at record high levels, so were wages.

There is nothing accidental about this. Employers take on most workers and pay highest wages when the outlook for profits is most promising. And it is out of past profits that they chiefly derive the capital to make those investments in new equipment and plant that increase the total national productivity out of which wages must be paid.

### POSTWAR INFLATION

My article in the June 25 issue, "The Great Swindle," presented a table compiled by Franz Pick showing the depreciation of 53 currencies in the ten-year period 1946–55. As the result of a typographical error occurring in Dr. Pick's office, unfortunately, the depreciation of the U.S. dollar was shown as only 17 percent, instead of the real figure of 27 percent. This correction only emphasizes the extent to which all American creditors, and nearly all Americans whose annual income has gone up less than 37 percent (the extent of the official cost-of-living rise in the ten-year period) have been cheated by the postwar inflation. And this inflation has not been brought about by malign outside forces, but by Federal fiscal and monetary policies. ❁

## Communist Production

July 30, 1956

Two articles by Harry Schwartz (in *The New York Times* of June 25 and 26) are disturbing both in themselves and as a symptom of a recent trend of thought in this country. The burden of the articles is this: "An economic race whose outcome could decide the fate of the world is in progress. The leaders of international Communism expect to win the contest by beating capitalism at its own game—production." Particularly because Schwartz is usually a careful and judicious writer on Russian affairs, these articles call for critical analysis.

On close examination most of Schwartz's statements are seen to be qualified and guarded. (The italics in the following quotations are my own.) "The

Communists *expect* to overtake and surpass the West industrially," etc. "It does not seem easy to raise industrial labor productivity 50 percent and collective farm productivity 100 percent in a mere five years, as the Soviet regime plans."

Yet the articles as a whole take the Communist plans and boasts very seriously. They are illustrated with solemn charts which compare U.S. *actual* production last year, not merely with the U.S.S.R. 1960 *goal*, but even with the "*possible* U.S.S.R. 1965 *goal*." And Schwartz's qualifying words are faint: "That this [Communist overall production] program will make progress seem difficult to challenge. *But that it will succeed in all its aspects seems open to question.*" Perhaps the understatement of the year.

### PROPAGANDA FIGURES

The net effect of the Schwartz articles, in short, is to scare the unwary Western reader into thinking that the Communists will soon surpass the free-enterprise U.S. and the whole West in *overall* productivity by Communist "planned" production methods.

It should be made clear that what Schwartz is discussing is not purely military production. In this respect everyone must agree that the Communists present a real menace. Conquest and war, and heavy industry expansion and similar preparations for conquest and war, have from the first been their primary and almost their sole objective. With us, military production has been only one among a very wide number of objectives.

Schwartz relies chiefly on studies of the official Soviet statistics of production. But there is no reason for supposing any of these statistics to be correct. They are published primarily for propaganda purposes. Until very recently, they consisted mainly of boasted *percentages* of increase, with no absolute figures that anyone could check against. When two Soviet statistics cannot be reconciled, it necessarily follows that one of them must be wrong. But even when two or more Soviet statistics *can* be reconciled with each other, it does not in the least follow that both or all of them must be right. They may be merely a set of matching fictions.

Then there is something which never gets into these statistics—the *quality* of the product. Millions of shoddy or ill-fitting shoes can look just as good in the statistics as the same number of first-rate shoes that fit. Square-footage of housing constructed can mean anything from shabby and jerry-built tenements to luxury apartments.

### SOVIET REALITIES

If we start talking not of "plans" and daydreams but of actualities, then one of the things to talk about, as compared with the marvelous actual record of American free



enterprise, would be the dismal failure of Khrushchev's virgin lands program last year. "Excluding the Ukraine" (I quote Schwartz himself in *The Times* of Dec. 18 last), "... the Soviet Government apparently got at least 4 million tons less grain from Soviet farms this year than in 1954." Next, one might consider the recent Poznan riots, desperate acts precipitated by a shortage of food. We might then examine the appalling condition of Russian housing. Finally, we might consider an article in a Polish weekly (probably printed at the risk of life) complaining, according to a *New York Times* report of July 15, of "mass unemployment, huge land waste, and food and housing shortage throughout Poland."

It is a strange procedure to compare American actualities with Communist "plans," boasts, or day-dreams for the future. ❀

## Communism as Producer

August 6, 1956

Last week I commented here upon two articles by Harry Schwartz in *The New York Times* of June 25 and 26 which, in spite of many qualifications, left the impression that Communism had a good chance of winning the "economic race . . . by beating capitalism at its own game—production." I pointed out that the articles mainly relied upon Soviet official statistics, and that there was no reason for supposing these propaganda figures to be true.

A conviction in the West that Communist "planning" and production methods *can* beat free enterprise in overall production would have such disastrous consequences that it calls for further scrutiny. I must again make clear that I am not talking (nor was Schwartz) of production purely for war purposes, upon which the Communist world concentrates, but of total production, including production for consumer welfare.

### FOOD AND HOUSING

That the recent riots in Poland were precipitated by an actual food shortage is now admitted even by Communist officials. Thus Edward Ochab, "regarded as Moscow's principal representative in the Polish Communist Party," confessed on July 20 last that Poland's Six-Year Plan not only had failed to produce enough coal and food but also had fallen short by 50 percent of its goal to raise wages. He conceded that while the Polish Bureau of Statistics reported to the Central Committee that real wages had increased 27.6 percent during the Six-Year Plan, the committee's own investigation showed that the increase was only

13 percent. There is no good reason for trusting even this "correction."

Yet American officialdom today seems to regard Russian statistics with respect and even awe. On Oct. 10 last, Secretary Dulles declared that U.S. production, at about \$400 billion, was "three times that of the Soviet Union." A writer in the *National Review* estimated that Russian production was only about half that claim. After thumbing through some old clippings, I incline to think this lower estimate much nearer the truth.

A study released by the U.S. Labor Department on July 12, 1947, estimated that the standard of living of the average American, in terms of what his weekly wages would buy, was almost 1,000 percent higher than that of the average Russian worker. A detailed comparison of food costs by the department in 1951 showed that it took the average Russian worker 769 minutes to earn enough to buy the same "food basket" as the American worker could buy with 100 minutes' work. In *The Times* of Oct. 24, 1950, an article by Harry Schwartz himself pointed out that "available data suggest that the typical Soviet housing pattern is still that of one family to a room"; that "the present crowding of housing in Moscow is appreciably worse than it was in 1939"; and that in Leningrad there was "an average of about twelve persons for each apartment."

Alfred Kohlberg recently presented strong reasons for doubting Russian statistics even on steel production. If the figures on steel production should prove to be fictitious or inflated, the whole set of Russian claims of expansion even in the heavy industries would be thrown in doubt.

### COSTLY ERRORS

And yet, rushing in on the basis of unestablished and highly improbable Russian boasts, a letter writer to *The Times* of July 8 last (a professor of economics!) triumphantly contended that the example of Soviet Russia disproved the Mises-Hayek thesis that a centralized tyranny cannot maximize or balance production because it can neither calculate comparative costs nor know consumers' wants. In a country like Soviet Russia, "still short of everything it needs," the letter writer argued blandly, "errors in planning are not fatal" because a wrong investment "is at worst premature and will soon be utilized." Yet it is, of course, precisely a country "short of everything it needs" that can least afford errors. If it builds giant power dams and steel plants by diverting labor and capital from food production, a few million citizens may starve before the "wrong investment" is "utilized." This is precisely the



kind of thing that is still happening behind the Iron Curtain. ❁

## Strike Aftermath

August 13, 1956

It may seem at first blush that no matter who lost by the steel strike, at least the workers immediately involved must have gained, because they won larger increases than they were offered. But let's see. In May, before the strike, steelworkers' earnings, according to official statistics, averaged \$100.28 a week. Counting the five weeks of the strike itself, and the man-days lost just before and after (to bank and re-fire blast furnaces, etc.), the steelworkers lost an average of about six weeks, or an average of, say, \$600 each under the old wage scale. But had the companies' offer been accepted without a strike, the steelworkers would have earned in those six weeks more than \$600 each.

### TO MAKE UP THE LOSS

Now the companies offered the workers for the first year an average increase in basic wage rates of 7.3 cents an hour (not counting "fringe" benefits, etc.). The union won for the first year an average basic wage increase of 9.5 cents an hour—or 2.2 cents an hour better. Assuming approximately a 40-hour week for the eleven months to end next July 1, a steelworker will then have made up \$41.80 of this loss. In the following year the union won an increase of 3.2 cents an hour above the companies' offer. So he will then make up \$64 more. In the third year, with an average hourly increase of 4.2 cents above the companies' offer, he will make up \$84 more.

At the end of the three-year contract, in sum, he will have made up, in basic wage rates, only about \$190 of the \$600 he lost in the strike. So at the end of his three-year contract, he will still be \$410 worse off than he would have been if the companies' offer had been accepted and there had been no strike.

Such a calculation is of course only approximate, necessarily involves assumptions about the future, and cannot be made indisputably precise. Many steelworkers, for example, had paid vacations of two or three weeks coming to them anyway. And there can be dispute concerning the impact of incentives and overtime on the exact amount of the loss. But it seems probable that even if the two complicated "full packages" are compared, including all fringe benefits, it will take more than five years for the individual worker to make up the losses he incurred during the strike.

If the workers directly involved in the strike did not gain, who did? Certainly not the companies. Their earnings will be cut by six weeks' idleness and by future increased labor costs. The idea that the companies can pass the increased labor costs—or more—along to the public, simply by raising prices, overlooks the fact that higher prices tend to reduce sales and production. In the long run higher costs of production will slow up steel industry expansion and mean less employment of steelworkers.

The buying public, and workers outside the steel industry, will lose by the strike in more than one way. Projects were held up during and shortly after the strike through lack of steel. Workers were laid off. When steel is in full supply again, the buying public will have to pay higher prices for everything using steel. The real wages of other workers will be reduced because they must pay higher prices for what they buy. But as the steelworkers' weekly earnings of more than \$100 even before the strike were already more than \$20 a week higher than the average weekly earnings of all manufacturing workers, the settlement will not make for less distortion, more balance, or more overall real purchasing power in the economy. It seems likely, on the contrary, to increase strain and imbalance, and to set off a new round of wage demands.

### INFLATION RATCHET

In fact, the outcome of the steel wage settlement must either be less employment or more inflation than otherwise. The latter is more probable than the former, at least between now and Election Day. Inflation now works on a built-in ratchet principle. Existing Federal legislation creates industrywide unions and makes it all but impossible for employers to resist demands for higher wages. Then the government follows inflationary money and credit policies to make the higher wage-costs payable. This further increases prices, leads to further wage demands, and so *ad infinitum*. ❁

## False Internationalism

August 20, 1956

There has recently appeared a 64-page pamphlet, by the European economist Wilhelm Röpke, called *Economic Order and International Law*. It is one of the most penetrating analyses that have yet appeared of the modern malady of false internationalism. Though it was a course of lectures before the Academy of International Law, it has been independently printed only for private circulation (A.W. Sijthoff, Leyden) and its contents deserve to be far more widely known.

Röpke's thesis has so many facets and corollaries that it is difficult to summarize in any short space. He begins by pointing out that a central element in the Socialist movement of the last hundred years has been the idea of the *international* mission of Socialism. Yet Socialism in practice (or any other brand of collectivism-interventionism, "planning," the Welfare State) has led to nationalism, economic isolationism, autarky—in brief, to international *disintegration*.

#### AN AS-IF WORLD MONEY

Röpke contrasts this international disintegration, brought about by the interventionist, collectivist, and inflationary policies followed by most governments today, with the "universalist-liberal" solution approached in the nineteenth century—and largely retained, for that matter, up to about twenty years ago. Nations did not surrender their sovereignty to some international super-state. They did not set up endless intergovernmental bodies like the United Nations, with its maze of sub-agencies, or the International Monetary Fund, or the European Payments Union, or the Schuman Plan. But they did adhere to a far more real international order, a sort of As-If World State, with an As-If World Money.

International law respected private property. The natural resources of the world were owned and developed by private persons, or by corporations in which anybody, whatever his nationality, could buy shares in the world's stock exchanges. International trade was obstructed only by tariffs. It was not ripped into shreds by exchange control, blocked currencies, devaluations, bilateralism, import quotas, export subsidies, balance of payments deficits, and "dollar shortages."

But the great achievement of traditional liberalism in the nineteenth century was the creation of a *de facto* world currency, the international gold standard. The gold standard meant that governments and central banks, in their money and credit policies, were subjected to a severe common discipline which prevented anyone from stepping out of line and upsetting international equilibrium.

#### DISCIPLINE OF GOLD

This discipline was economic rather than political. Any disobedience to the rules was promptly followed by consequences which every government found it to its own interest to avoid. Governments were continuously compelled to coordinate their money, credit, and fiscal policies in such a way that the resulting monetary unity of the world was not very different from a genuine *de jure* international currency system.

The politicians destroyed this system, and now treat it as utopian. But it is their proposed substitutes that are

really impracticable and utopian. Professor Röpke analyzes the fallacies behind the notion of European economic "integration" through a collectivist super-state. He shows how advocacy of this utopian ideal has drawn attention away from the first real step in any reform, which is a return to free convertibility of currencies. This presupposes the abolition of exchange control. He dissects the failure of the International Monetary Fund, and particularly of the European Payments Union, which compels its creditor members (and ultimately the American taxpayer) to subsidize the monetary and fiscal follies of the debtor countries, and which sets up, at best, a closed currency block discriminating particularly against the dollar area. He points to the arbitrariness and tensions inherent in the Schuman plan.

Röpke proves, in short, that collectivist planning on the national scale must find its counterpart in national autarky, and that real international economic cooperation is possible only with free markets, free competition, and a freely working price mechanism. ❁

## Invitation to Seizure

August 27, 1956

How did the West manage to get itself into the position where it can be blackmailed or robbed by any petty pirate, and hardly dares defend its own property or treaty rights?

It was not always so. Compared with our own era of war and constant dread of war, the nineteenth century (or from 1815 to 1914) was an era of international peace, disturbed, apart from our Civil War, only by a few short conflicts. There was no United Nations, but there was real respect for international law. And one of the cornerstones of international law was the acknowledged right of each country to protect the lives, liberties, and property of its citizens, wherever they were. If any little despot or robber chief defied the treaty rights of, say, Great Britain or the United States, an ultimatum went out, or the Marines landed. Such action is now in disrepute, but no effective substitute has been found. It protected citizens in the peaceful possession of their property abroad as well as at home.

#### MEXICO AND IRAN

This state of affairs began to disintegrate during the first world war. Even in the interwar period the great powers rashly set precedents which undermined the foreign property rights of their own citizens. When on March 18, 1938, President Cardenas of Mexico seized the British and American oil properties there, Mexican

orators and newspapers told their people that President Roosevelt had approved the seizure. His public protest, in any case, was gentle, belated, and perfunctory. Two weeks later, he publicly said he was pleased that Mexico was willing to pay compensation, but he hoped the American companies would limit their claims to the amount of their actual investment. This was putting pressure, not on the Mexican Government to pay the going market value of the properties, but on the American owners to accept less. The American owners, in fact, in the end got less than \$30 million for properties valued at \$120 million.

On May 7, 1943, after Bolivia had defaulted on a private American loan, President Roosevelt actually apologized to the then Bolivian President on the ground that an interest rate of 8 percent was too high anyway, and that “of course” Bolivia was unable to pay either interest or principal. This informed every foreign country that the American Government would not protect the foreign investments of its citizens from seizure or repudiation unless it decided (retroactively) that it approved the terms.

In World War II, the “democratic” victors even put pressure on neutral countries to seize the private property of citizens of the conquered nations. Then came an astonishing performance after Mossadegh had seized the Anglo-Iranian oil properties. President Truman wrote to him on July 9, 1951: “You know of our sympathetic interest in this country in Iran’s desire to control its natural resources. . . . We were happy to see that the British Government has on its part accepted the principle of nationalization.” This in effect supported Mossadegh’s contention that a government is entitled to sell a concession, invite foreign capital in, then repudiate its contract and seize the capital.

The worldwide spread of Socialism and disregard of private property was ominously revealed on Dec. 11, 1952, when 31 members of a United Nations committee approved a proposal, the U.S. alone dissenting, permitting any member nation to expropriate natural resources without compensation. A majority of the U.N. General Assembly itself accepted the resolution in a modified and vaguer form on Dec. 21, 1952.

#### **DILEMMA OF SUEZ**

Now another little dictator has seized the Suez Canal, and the injured governments, instead of standing flatly against the violation of property rights or even the flagrant treaty violation, talk of referring the question to an ineffective United Nations, or having a friendly conference with the thief, or drawing up a new treaty for him to violate.

If investors in foreign countries have no assurance against expropriation, then private investment abroad will cease. The worst sufferers, in the long run, must be the very “underdeveloped” countries that insist on the right of arbitrary seizure. ☼

## **Democratic Claptrap**

September 3, 1956

Is the Democratic platform really meant to be taken seriously? It is shrill, intemperate, long-winded, repetitious; a compound of abuse, half-truths, untruths, and glaring self-contradictions. It is a bid to buy the votes of every conceivable pressure group. It promises utter recklessness in spending the taxpayers’ money. If its framers had deliberately tried to write a parody of a political platform they could hardly have done better. The greatest danger of a Stevenson victory is not that he might repudiate his platform’s pledges, but that he might try to keep them.

Nothing is too bad for the platform framers to say about the Republican Administration. It seems that practically every measure it took has already proved “disastrous.” The Democrats alone, one gathers, know how to conduct foreign affairs. They alone “wrote humanity upon the statute books.” Republicans represent only “special privilege”—“government by the few, and for the few.” It is startling to discover in fact, that the American people “are now ruled by a government which they did not elect and to which they have not given their consent.” Who cast the 34 million votes for President Eisenhower becomes a baffling mystery.

#### **PROSPERITY ‘MYTH’**

It appears, also, that our present prosperity is no prosperity at all, but just another Republican myth. Our national income is at the highest figure on record. But one learns from the Democratic platform that the Republican Administration has “crippled and stunted” our economic growth. Wages are not only at the highest average level on record, but have raced far ahead of living costs. Yet we are informed by the Democratic platform that “wages lag.” And for some inscrutable reason (a will to political suicide?) there is a “Republican crusade against full prosperity.”

At any rate, present prosperity can’t compete with Democratic promises. Instead of the present picayune but record annual rate of \$408 billion of gross national product, the Democratic platform promises “a \$500 billion national economy in real terms”; an “increase of 20 percent or better in the average standard of living,” and



an even bigger increase, through “special emphasis,” to families now making less than \$2,000 a year. The platform promises. But space forbids even the barest list of its promises.

The platform is riddled with self-contradictions. It pledges “a truly balanced Federal budget.” How? By promising increased expenditures in a hundred directions to benefit every imaginable group. The platform repeatedly denounces the Republicans for “false economy” on national defense and for “political considerations of budget balancing.” All this would imply a huge increase in taxes to pay the higher expenditures. Instead, the platform promises “tax relief”—in particular by increasing the personal tax exemption of \$600 “to a minimum of at least \$800.” This alone would mean a loss of \$4.5 billion in tax revenues.

### **MORE CONTRADICTIONS**

But balancing the budget by simultaneously boosting expenditures and slashing taxes is no trick at all for the Democratic platform makers. They pledge themselves to “expand world trade” and “to support vigorously the Hull reciprocal-trade program.” And they propose to do this by preventing “serious economic injury” to anybody by any tariff cut and by continuing quotas on agricultural imports. They endorse the Marshall Plan and more economic assistance both to Israel and the Arab States. But they also tell us that “the time has come for a realistic reappraisal of the American foreign-aid program.” So every man must decide for himself whether the platform is for more foreign aid or for less.

The platform endorses states’ rights. But it insists that the Taft-Hartley Act must be repealed because it permits state “right to work” laws. The platform denounces corporate monopolies but is completely silent about industrywide labor monopolies. It deplores the fact that “American farmers have gone deeper and deeper into debt.” It proposes to cure this by providing “an increased reservoir of farm credit”—in other words, by encouraging them to get deeper into debt. And so on and on.

As for the Republican platform—but that is another column. ☼

## **GOP Double-Think**

September 10, 1956

Last week I remarked in this place that the Democratic platform was intemperate, repetitious, full of half-truths, untruths, and self-contradictions. By comparison, at least, the Republican platform has several merits. It is just as repetitious; it is also full of half-truths and

misleading implications; but its tone is much more temperate, its program is less fantastic, and it pays at least lip service to the ideal of limited Federal intervention and limited governmental power:

“We hold that the major world issue today is whether government shall be the servant or the master of men. . . . We hold that the strict division of powers and the primary responsibility of state and local governments must be maintained, and that the centralization of powers in the national government leads to expansion of the mastery of our lives. . . . We are unalterably opposed to unwarranted growth of centralized Federal power.”

But when the platform gets down to details, these words are as if they had never been written. The main record of the Eisenhower Administration, and even most of the present Republican boasts and promises, run directly counter to them.

### **SELF-CONTRADICTIONS**

“We pledge . . . further reductions in government spending. . . .” This is followed by promises of continued or increased spending in uncountable directions. The foreign giveaway program is to be continued. “Small business” is to get loans too unsound for private lenders or investors to make with their own money. More Federal funds are to be spent on more local schools, more subsidized local housing, expanded social security, health reinsurance, flood insurance, more aid to veterans, a grandiose public-roads system. Farmers, in addition to their previous price supports, are to get “soil bank” subsidies, crop insurance, drought and flood insurance, “supplemental credit.” Whenever “producers of perishable farm products” produce “temporary market surpluses,” the government is to buy up the surplus with the taxpayers’ money and give it away. This promise, for some strange reason, is not extended to dealers stuck with a surplus of last year’s automobiles or television sets or perishable novels. For further farm relief, the Republicans promise to “expand” the school-milk and school-lunch program. All of this is obviously inconsistent with protestations of unalterable opposition to “unwarranted growth of centralized Federal power.”

It is obviously also incompatible with the announced fiscal aims of the Eisenhower Administration. You cannot reduce government spending while you increase it. You cannot at the same time have more spending, “further reductions in taxes,” and “continued balancing of the budget.” The Republican platform even pledges, in the face of this program, “gradual reduction of the national debt.” Under President Eisenhower, in fact, the national debt has risen by \$7.7 billion—not to mention



what has happened to the government's contingent liabilities.

### CONTINUED INFLATION

Nor is the fiscal record or program consistent with the platform's announced aim "to maintain the purchasing power of a sound dollar." The Eisenhower Administration, until recently, has been favored with good luck in this respect. But wholesale prices are now 3 percent higher than a year ago, while the consumer price index has hit its highest level on record. Behind this lies a steady expansion in the supply of money. The nation's bank deposits and currency increased an average of \$6.9 billion a year in the last four Truman years—and an average of \$6.9 billion a year in the first three Eisenhower years!

Mr. Eisenhower has come sincerely to believe that the maintenance of "full employment" is primarily a Federal responsibility, that the way to achieve this goal has been discovered, and that it consists mainly in imitating and expanding most of the inflationary welfare-state policies of the New and Fair Deals. But this presents a grave dilemma to those voters who are convinced that the real future of America lies in the preservation of individual initiative, self-reliance, and freedom, and who watch with growing concern what Mr. Eisenhower himself has called "the growth of a swollen, bureaucratic, monster government in Washington." ❁

## 'People's Capitalism'

September 17, 1956

The Voice of America has recently been pointing out that capitalism in the United States today is a "people's capitalism." Even in the special sense that millions of Americans now share in the direct ownership of industry, and many more millions in its indirect ownership, the phrase is amply justified.

The major facts were summarized in *Newsweek*, July 30. This country now has some 10 million direct share owners in business. Nearly 70 million Americans hold savings accounts and 115 million, life-insurance policies.

The new campaign of the U.S. Information Agency, judging from the angry reaction it has provoked from Soviet sources, must be effective. A "people's capitalism" takes over their own favorite adjective (without falling into the childish tautology of a "people's democracy"), and boldly defends what the Communists have always vilified as their real archenemy, capitalism.

### VARGA'S ARGUMENTS

The Soviet leaders have now called on their top economist, Eugene Varga, to step in and lead the fight against American capitalism. This year he has written two articles in a weekly journal called the *New Times*, published in ten different languages. As these articles total more than 5,000 words, it is impossible here to deal in detail with his tortured statistics and arguments. Insofar as his arguments are capable of any summary, they reduce themselves to two: (1) It isn't true that ownership of American industry is widely spread. (2) But if it is true, what of it?

In the first part of this argument he collides hopelessly with solid facts. In the second part he trips over his own contradictions. It is particularly unwise of him to argue that: "[Private American stock] ownership is of course illusory; the workers have absolutely no influence on the operation of the corporation as a whole or of its individual plants, including those at which they themselves are employed." Such an argument is dangerously likely to call the Russian workers' attention to the completely illusory character of their own supposed "people's" ownership of the factories in which they work, and to the lack of influence they exercise, as workers or individuals, on the overall Soviet production plan or on the conditions of their own employment.

"But even if a worker does own some shares," continues Varga, "can he be considered a capitalist? Of course not. Dividends are a negligible quantity in the budget of any worker, however highly paid." In fact, he might have continued, dividends are not only a small percentage of the workers' income, but of the whole nation's income—precisely because wages bulk so large. Out of total U.S. personal income of \$306 billion in 1955, only \$11 billion was in the form of dividends, while \$217 billion came in the form of wages and salaries.

It is at this point especially that Varga gets snarled in his own Marxian dialectics. He considers it outrageous that the salaries of half a dozen U.S. corporation executives should range from \$213,000 to \$686,000 a year. But as an undeviating Marxist he would have to argue that even so these executives must be underpaid, because they are after all hired hands, and the corporation owners must be withholding for their own profit the "surplus value" that the salaried officials produce. And as Varga does in fact insist on the long-discredited Marxist fallacy of "surplus value," he should never forget that his logic compels him to regard a television star getting \$500,000 a year as being "exploited," and the owner of a barbershop with one hired assistant as being an "exploiter."

## MAXIMIZING INCENTIVE

But wholly apart from the preposterousness of Marxist theory, I hope the Voice of America will extend its argument to show not merely that present-day American capitalism is a “people’s capitalism,” but that *all* capitalism (in the sense of a really free, competitive private enterprise society) has *always* been a “people’s capitalism.” It tends to give to labor what labor creates, to capitalists what capital creates, and to entrepreneurs what their coordinating function creates. And by doing so it maximizes the incentives to production and increases individual freedom as it multiplies the total wealth to be shared. ❁

## How High Is 3 Percent?

September 24, 1956

The extent of the national pressure for continued inflation was demonstrated by the reaction in political, business, labor, academic, and journalistic circles to the general rise of the discount rate of the Federal Reserve Banks to 3 percent. The most vociferous reaction was that of Democratic orators, already expressed in the Democratic platform, that this “hard-money policy” was just part of “the Republican crusade against full prosperity for all.”

But this time there were new objections. (1) The higher money rates were not only denounced, as on previous occasions, as “deflationary”; they were also criticized (often by the same people) as (2) ineffective, and (3) actually inflationary.

While even the first and second objections are of course incompatible with each other, either could be justified in principle, depending on the real state of the facts. If a 3 percent discount should prove in itself high enough to lead to an actual contraction of the total volume of bank credit outstanding, it would be deflationary. If such a rate were at least high enough to halt any further expansion in bank credit, it would halt inflation. This, in fact, is precisely the usual purpose in raising the discount rate. If a 3 percent discount rate does not prove high enough to discourage further expansion of bank borrowing, it will of course be ineffective.

### HIGH ENOUGH?

At the moment it does not seem probable that a 3 percent discount rate will in itself prove sufficient to halt the present inflation. True, it is the highest rate since 1933; but prior to 1930, 3 percent was the *lowest*

discount rate. The rate went as high as 7 percent in the boom of 1920 and to 6 percent in 1929.

Two current fallacies, however, must be rejected. One is the idea, put forward by a prominent Wall Street house, that: “High taxes make interest rates relatively unimportant to businessmen. The government pays a little more than half the interest charge, so that a 6 percent rate really costs the businessman only 3 percent,” etc. It is not true that the government “pays” half the interest charge, as any businessman whose project does not yield a net profit soon discovers. The government merely permits a corporation to deduct full interest payments before seizing 52 percent of what the company has left as net profit. Higher money rates will still discourage marginal borrowers.

A much more dangerous fallacy is the belief that higher money rates are actually inflationary. One of the country’s leading newspapers, in its news story on the Aug. 24 discount rise, “reported” matter-of-factly: “It will take time for today’s action to be reflected in retail prices. . . . However, the high cost of working capital . . . is bound to be reflected, even if slightly, in the ultimate prices paid by the consumer.”

### A DANGEROUS FALLACY

This contention that a rise in short-term interest rates is actually inflationary is disquietingly familiar. I remember encountering it three years ago in an interview with the head of the central bank of a leading European country that had already been, and has since been, ravaged by inflation. The fallacy (1) greatly overestimates the percentage that interest payments on bank loans constitute of the average business firm’s total production costs; (2) falsely assumes that a rise in such costs can be passed along to consumers in higher prices, regardless of what happens to consumers’ monetary purchasing power or willingness to buy; and (3) most importantly, overlooks the fact that higher interest rates themselves reduce the volume of business borrowing compared with what it would otherwise be. They therefore tend to halt the expansion of money-and-credit supply, and consequently to halt the rise of commodity prices.

The present rationalizations of cheap money are another symptom of how deep-seated inflationary sentiment has become. They also illustrate the theme, so well developed in the August Survey of the Guaranty Trust Co. of New York, of how the growth of the doctrine that government must assume “social responsibility” for maintaining continuous “full employment” has in fact led to the growth of fiscal and monetary irresponsibility. ❁

## A Free Man's Library

October 1, 1956

In *The Road to Serfdom*, published in 1944, Friedrich A. Hayek made an analysis, profound and prophetic, of the drift toward a statist or totalitarian ideology even in the Western world. "Although," he wrote, "we had been warned by some of the greatest political thinkers of the nineteenth century, by de Tocqueville and Lord Acton, that socialism means slavery, we have steadily moved in the direction of socialism. . . . We are rapidly abandoning not the views merely of Cobden and Bright, of Adam Smith and Hume, or even of Locke and Milton, but one of the salient characteristics of Western civilization as it has grown from the foundations laid by Christianity and the Greeks and Romans. Not merely nineteenth- and eighteenth-century liberalism, but the basic individualism inherited by us from Erasmus and Montaigne, from Cicero and Tacitus, Pericles and Thucydides, is progressively relinquished."

### SPREAD OF SOCIALISM

Since that book appeared the totalitarian regimes in Germany and Italy, and even in the Argentine, have been overthrown. But the totalitarian regime in Russia has enormously increased its dominion and power. The newly "liberated" countries of China, India (and generally in the Near East, Far East, and Africa) are ruled either by socialists or outright Communists. In Europe and in America the socialist ideology has on net balance gained. It is true that the Labour Party is out of power in Britain and that a Republican regime now rules in Washington. But the Conservatives in Britain have not dared to repeal most of Labour's socialist and welfare-state planning, while here the Eisenhower Administration has not only retained but expanded most of the New Deal measures.

Now this drift of mass opinion is not the result, as it is the fashion to think, of new knowledge or great new discoveries in the realm of economics or politics. It is a revival of immemorial fallacies, a turning back of the clock to the mercantilistic theories refuted by Adam Smith, to the inflation and price-fixing of the France of 1789, or toward the totalitarian socialism of the Incas. This drift of opinion has come, in brief, because most of the so-called leaders of thought in the world today have not the remotest idea of the richness and range of the literature of freedom.

In an effort to bring this literature together, and to guide readers through this great treasury of thought and knowledge, I recently published a bibliography called *The Free Man's Library* (Van Nostrand). I ended up with a collection of more than 550 books, devoting

to each from half a dozen lines to a page of description, synopsis, or comment. But because the prospect of reading or even choosing among 550 books may be discouraging or bewildering, I gave in an introduction, and present in a modified form here, a list of the "ten best" classics on freedom, another list of the "ten best" contemporary works, and a suggested "introductory reading course."

### THE ANTIDOTE

In chronological order the list of "classics" is: Milton's *Areopagitica*; Locke's *Second Treatise on Government*; Hume's *Essays Moral, Political, and Literary*; Adam Smith's *Wealth of Nations*; selections from Edmund Burke; Bastiat's *Economic Sophisms*; de Tocqueville's *Democracy in America*; Mill's essay "On Liberty"; Herbert Spencer's *The Man vs. the State*; and Lord Acton's *Essays on Freedom and Power*.

The "ten best" contemporary works in alphabetical order, are: B.M. Anderson's *Economics and the Public Welfare*; Max Eastman's *Reflections on the Failure of Socialism*; Hayek's *The Road to Serfdom*, and, in addition, a book edited by him, *Capitalism and the Historians*; John Jewkes's *Ordeal by Planning*; Ludwig von Mises's *Socialism: An Analysis* and his *Human Action*; George Orwell's *Nineteen Eighty-Four*; Lionel Robbins's *The Great Depression*; and Wilhelm Röpke's *The Social Crisis of Our Time*.

A good "introductory reading course" would be: Hayek's *Road to Serfdom*; Mill's essay "On Liberty"; Max Eastman's *Reflections on the Failure of Socialism*, and, to cap it Mises's *Socialism: An Analysis*. ❁

## Policies and Votes

October 8, 1956

In 1954, the Maine elections forecast the Democratic Congressional victory that followed. This year the Maine elections seem to forecast an even greater Democratic Congressional victory. They even throw doubt on the previous complacent assumption that "Ike is a shoo-in."

Republican excuses are not convincing. President Eisenhower declared at a press conference that he did not regard the Maine results as marking a trend: "Maine had a very popular governor . . . and his majority was such that he helped every other person on the ticket." But by the same reasoning the popularity of the President did *not* help the Republicans running for Congress.



## 1954 AND 1948

Mr. Eisenhower's chosen advisers, in fact, give no sign that they understand the real lesson of the Maine elections, any more than they seem to have understood the real lesson of the Congressional defeat of 1954 or the Dewey defeat of 1948. Writing in *Newsweek* of Nov. 1, 1954, just prior to the Congressional elections of that year, I offered an interpretation of the probable result that may apply with even greater force today:

"It is this so-called middle-of-the-roadism, this semi-New Dealism, which will probably be the main cause of a Republican Congressional defeat if it occurs. It is amazing that President Eisenhower should exactly duplicate the incredible error that caused Governor Dewey to snatch defeat out of the very jaws of victory in 1948. Like Dewey, he has ignored the traditional Republican philosophy in order to go after the votes of the supposed moderate New Dealers—the so-called middle-of-the-roads of both parties. Like Dewey, he has taken for granted the votes of the orthodox Republicans on the assumption that they cannot vote for New Deal Democrats and therefore 'have nowhere else to go.' But Republican conservatives proved in 1948—as they seem only too likely to prove again in 1954—that they do have a place to go. That place is anywhere but to the polls. They can stay home, play golf, or take a walk.

"This is precisely and demonstrably what they did in 1948. Only 49 million voters bothered to vote for a President in that year compared with 61 million in 1952. Mr. Truman won by default. He got the votes of only about 25 percent of the total *eligible* electorate. Mr. Eisenhower's real problem today, like Dewey's unrecognized problem in 1948, is not that the American public is hot for a return to Trumanism and New Dealism; the real problem is the indifference and apathy of conservative Republicans."

In the two years since the 1954 elections the Administration's policies have swung more and more to the left. Even Adlai Stevenson, in accepting the Democratic nomination, admitted that: "After twenty years of incessant damnation of the New Deal [the Republicans] not only haven't repealed it, but they have swallowed it, or at least most of it. . . . They have caught up with the New Deal at last."

Mr. Eisenhower, in fact, seems to have been following the theory attributed to Sherman Adams—that if Republicans take over the New Deal they will take over former Democratic voters with it. The record to date suggests that such tactics tend only to alienate traditional Republicans without winning over New Deal Democrats, who put more trust in the originators of

the program than in its imitators. Mr. Eisenhower's popularity is personal, and in large part unrelated to his policies. For some it exists in spite of his policies. The slogan of his promoters has always been, significantly, "I like Ike," not "I like Ike's policies."

## NO COATTAILS

Other Republican candidates, it has been shown, cannot ride in on Ike's coattails. There are no coattails on the Eisenhower jacket. It is not more energetic political campaigning that can save the Republicans from a Congressional defeat, but a highly improbable return before election to their traditional Republican philosophy.

The President's advisers may think that Administration New Dealism is depriving the Democrats of issues, but its more important effect is to deprive the Republicans of zeal: Some of Stevenson's recent demagogic and irresponsible proposals, however, may yet frighten enough voters back into the Eisenhower camp. ❀

## Why Anti-Capitalism?

October 15, 1956

The supreme paradox of the present age is this. Capitalism—particularly in America, where it has reached its highest development—has brought to mankind the greatest liberty, the greatest security against violence, despotism, and expropriation, the greatest abundance, that it has ever known. To the common man it has brought the benefits of mass production and mass consumption, and amenities that, a century ago, were not even within the reach of kings. Yet this very capitalism is in our age daily denounced by the ruling clique in at least half the nations of the globe. More than half the world's population has been taught to regard capitalism as the worst of all social evils. And within the "capitalistic" countries themselves, most of the "intellectuals" look upon a genuinely free capitalism with distrust. They never tire of satirizing and ridiculing either the system itself or the businessmen who are most successful under it. They advocate "reforms" ranging from more government intervention or "planning" at one end to outright Socialism or Communism at the other.

## THE PARADOX

Why? Why, at the very moment when capitalism has brought the greatest material and scientific progress known to history should it be meeting with its greatest disparagement and opposition? This is the question Prof. Ludwig von Mises has set himself to answer in



a short book called *The Anti-Capitalist Mentality* (Van Nostrand, \$3.75).

His answer is that the opposition to capitalism finds its main source in the very benefits of capitalism. In a society based on caste and status, the individual could ascribe his adverse fate to conditions beyond his own control. He had no reason to be ashamed of a humble rank, because conditions made it impossible to rise above the class in which he was born. But under capitalism a man's station in life depends largely upon his own qualities, enterprise, and actions or upon his own defects, errors, and failures. "The much talked about sternness of capitalism consists in the fact that it handles everybody according to his contribution to the well-being of his fellow men. The sway of the principle, *to each according to his accomplishments*, does not allow of any excuse for personal shortcomings." And as nearly everybody can find someone who—with no better start—has succeeded better than himself, large numbers of us are tempted to blame the result on "the system," and to imagine that we would have been or could still be much better off under some other system, such as Socialism.

#### ROLE OF ENVY

Mises applies this central thesis to the common man, to many white-collar workers, professors, scientists, novelists, journalists, playwrights, actors, and other "intellectuals." Because his book is so uncompromising, it is bound to arouse strong dissent. Many readers will question whether the envy and frustration that Mises describes constitute a sufficient explanation of today's anti-capitalist mentality. Others will declare that he overstates the role played by these motives as compared with sheer well-meaning confusion. Still others will contend that many of his statements are too sweeping and unqualified.

But Mises is much too good a logician not to recognize that the arguments against capitalism cannot be answered merely by an *ad hominem* retort that they spring from discreditable motives. In his great works, *Human Action* and *Socialism*, he has spelled out in full the real arguments for capitalism and against Socialism. And he restates them here in summary form:

"The characteristic feature of modern capitalism is mass production of goods destined for consumption by the masses. The result is a tendency towards a continuous improvement in the average standard of living, a progressing enrichment of the many. . . . On the market of a capitalistic society the common man is the sovereign consumer whose buying or abstention from buying ultimately determines what should be produced and in what quantity and quality. . . . The profit system makes

those men prosper who have succeeded in filling the wants of the people in the best possible and cheapest way." ❁

## Lesson from England

October 22, 1956

It would profit us as a nation (including especially the Republican leaders) to study recent economic policies and political results in Britain. When the British Labor Party came into power in 1945, it launched upon a policy of Socialism, "planning," inflation, and "full employment." England stumbled from crisis to crisis. The Conservatives were voted back in 1951. They held on in the new elections of May 1955. But those voters who thought the Conservatives would dismantle the Socialism and halt the inflation of the Laborites were disappointed. The Conservatives did arrest the further progress of Socialism, dropped some price-fixing, freed a few markets, and allowed interest rates to go up enough to slow down the inflation. And then the new regime lost its nerve. It lacked the conviction and the courage even to attempt to denationalize the coal mines, the railroads, gas and electricity, telephone and telegraph service, or the Bank of England. It kept all the welfare state schemes. It still keeps rent control. And it hangs on like grim death to exchange control.

#### 'FULL EMPLOYMENT'

An illustration of the controllist ideology that now governs even the Conservative Party was given by the speech of Harold Macmillan, Britain's Chancellor of the Exchequer, at a meeting of the International Monetary Fund on Sept. 26. The Chancellor pays lip service to the need of each member country "to follow sound internal policies." But, he continues: "We must remember that governments today are pledged, and rightly pledged, to policies of full employment and a high level of economic activity. They cannot, therefore, push their fiscal and monetary policies to the point of outright deflation." Translated into more candid terms, this means that governments today dare not halt their inflationary policies if such a halt threatens to bring even some temporary unemployment.

In the last twenty years, governments have demanded more and more direct controls over their national economies to try to suppress the undesirable results of their own inflationary "full employment" policies.

Chancellor Macmillan admits that he has already been driven "to supplement general monetary and fiscal

policies with more discriminating measures, notably the control of hire purchase" (installment-buying). This is only a beginning. If he insists on the continuance of inflation and exchange control, he will find himself driven to additional direct controls. He is concerned because "increased personal spending competes for the same resources as are required for exports and for capital goods." But if monetary inflation were boldly stopped, and the pound left to find its own level in a free market, this "problem" would disappear. The market would decide, infinitely better than any bureaucrat, how much of the national resources would go into consumption and how much into investment, how much into domestic production and how much into export.

### POLITICAL RESULT

Even today Britain's Chancellor still talks of "the world dollar shortage." A decade ago an eminent British economist, Roy Harrod, rightly called this "one of the most absurd phrases ever coined." Though British exchange control was slapped on overnight, as a "war emergency" measure, it still exists. And we find Harold Macmillan eleven years later, still talking timorously (and unconvincingly) about taking "such steps as we can from time to time to liberalize our arrangements for trade and payments."

Economically, exchange control is not merely futile but pernicious. And where has all this timidity in dismantling Socialistic controls got the Conservative Party politically? A hint was given in a by-election in Tonbridge on June 8 last, when the plurality of the Conservative over the Labour candidate dropped from 10,196 in the General Election of 1955 to 1,602. This drop of 8,594 was wholly the result not of any gain in the Labour vote, but of a drop of 9,000 in the Conservative vote. The abstentions were due, as one commentator put it, "to a protest against a Conservative government which has forgotten to be conservative." There may be still time for our own Republican high command to profit from the lesson. ⚙

## Reasons for Apathy

October 29, 1956

The public-opinion polls, various other political check-ups, and the elections in Alaska, coming on top of those in Maine, all seem to forecast (1) that the total vote will be substantially less, at least in proportion to the number of eligible voters, than in 1952; (2) that Mr. Eisenhower will win, but by a narrower popular and electoral margin than last time; and (3) that the

Democrats will control Congress by an even more decisive margin than they do today.

This outlook could of course be changed between now and Election Day by some major blunder on either side or some other unexpected event. I present it not as my own, but as a composite forecast. My chief purpose here is to discuss the consequences of such an outcome.

These consequences would depend heavily not only on the election result itself, but on the dominant interpretation of that result. If it is the same interpretation as the one that has prevailed among New Dealers and among those advisers who seem until now to have most influenced Mr. Eisenhower, then it will be concluded that the Republicans were denied the control of Congress because they refused sufficiently to divest themselves of their traditional "ultraconservative," "right wing," or "reactionary" opinions, and that Mr. Eisenhower had been re-elected because he had moved sufficiently to the left to get into the middle of the road.

### UNLEARNED LESSON

It is as likely as not that this will in fact be the prevailing interpretation. The Republicans have so far failed to learn the lesson of the Dewey defeat of 1948 or their Congressional defeat in 1954. The first part of this lesson is that you cannot win with a me-too policy. You cannot defeat the original New Dealers with Johnny-come-lately New Dealers. New Deal addicts prefer the stuff straight, not diluted with soda water. Mr. Eisenhower seems likely to survive by his sheer personal popularity. But his charm and amiability are personal and nontransferable, and most Republicans will probably find themselves under a heavy handicap.

The second part of the lesson is that wherever a Republican Administration does have the courage to substitute a more conservative policy for a New Deal policy, it must explain and defend its course at least as vigorously and tirelessly as its opponents attack it. And it must do this as it goes along. It cannot afford to leave the defense to a few speeches just before election.

It is possible, of course, that the Republicans who survive this time will see at last that their only hope is to rebuild a coherent conservative philosophy and record to stand on in the next election.

### ECONOMIC OUTLOOK

But if the election result is the one that seems at the moment most probable—Mr. Eisenhower with a Democratic Congress—the immediate outlook for a conservative or responsible economic and monetary policy is not bright. It should hardly be necessary to point out again at this late date that the bulk of Mr. Eisenhower's foreign and domestic policies are essentially continuations and extensions of New Deal policies.

We need merely take, as typical examples, farm subsidies, the compulsory minimum wage law, social security, and inflation. The Republican Administration, like the Democrats, believes in farm price supports—only not quite as high. It believes, like the Democrats, in a Federal minimum wage—only not quite as high. It believes, like the Democrats, in expanding social-security benefits—only not quite as recklessly. It believes, like the Democrats, in inflation—only not quite as much. Almost nowhere is there any difference *in principle*, only in degree.

It is this situation that now causes so much soul-searching among conservative Republicans, and so much apathy on the part of the great body of voters. Whichever of the two major party candidates they vote for, the subsequent policy will probably be more governmental control over our lives, more intervention, spending, and inflation. But even differences of degree are important, and in the matter of inflation, very important. That is why most conservatives will end by voting for Mr. Eisenhower, but with less enthusiasm than four years ago. ❁

## Party of Inflation

November 5, 1956

“Americans are on a luxury-craving and luxury-buying binge unsurpassed perhaps by any other period in U.S. history.” So concludes *The Wall Street Journal*, in a story supported by some startling examples. Sales are soaring of more expensive clothing, furniture, foods, liquor, foreign tours, jewelry, furs, Cadillacs.

Some of the reasons are obvious: The highest employment, weekly wages, and national income on record. Personal income has been running at an annual rate of \$325 billion, compared with \$306 billion in 1955 and only \$227 billion as recently as 1950. But this is not the whole story. Americans in nearly all income brackets are on a huge spending binge, not merely because of their present prosperity, but because they assume that their current high incomes will continue or even increase. People do not mind paying high prices for luxuries this year, if they believe prices may be even higher next year. Now the Democratic candidate for President has been telling his audiences that they are “deeper in debt” than ever before. As a statement of fact this is correct. Installment debt outstanding in July of this year was \$29.1 billion, compared with \$18.7 billion at the end of 1952, and \$6.7 billion at the end of 1947. Total consumer debt shows similar comparisons. And mortgage debt outstanding on one- to four-family

nonfarm houses at the end of last June totaled \$94.2 billion compared with \$58.5 billion at the end of 1952, and with only \$18.6 billion at the end of 1945.

### WHY ‘DEEPER IN DEBT’?

But the implication of Stevenson’s “You’re deeper in debt” is the exact opposite of what he supposes it to be. People are borrowing more (and getting more credit) precisely because they are so prosperous and so confident about the future.

In *Newsweek* of May 7, I called attention to the late Lord Keynes’s belief that there is a “fundamental psychological law, upon which we are entitled to depend with great confidence . . . that men are disposed, as a rule and on the average, to increase their consumption as their income increases, but not by as much as the increase in their income.” Leading disciples regard this “consumption function” doctrine as “Keynes’s most notable contribution” to economics. I pointed out, by a comparison of official statistics of national income and savings over the preceding eleven years, that American consumers acted in accordance with Keynes’s “fundamental psychological law” in only four of those years, and actually *reversed* the law in seven of them.

### KEYNES’S ‘LAW’

Keynes went on to contend that his “law” applied “especially . . . where we have short periods in view, as in the case of the so-called cyclical fluctuations of employment.” Yet it should now be obvious that this is especially where any such law does *not* meaningfully apply, and where the very reverse is apt to apply. In a depression, people still employed tend to contract their consumption-spending even more than their income has fallen, precisely because they become unsure of the continuance of their jobs and income and suspect that the prices of what they buy will be even lower next month or next year. During “full employment,” on the other hand, many people, as now, tend to increase their spending by an even greater percentage than the increase in their incomes, and even go heavily into debt to buy consumption goods, because they are confident (rightly or wrongly) of the continuance and further rise of their incomes. They assume that the inflationary boom will continue and that consumer-goods prices will be even higher next year. They are borrowing dollars that they expect to pay off in cheaper dollars.

Yet Stevenson deplors this borrowing on precisely the wrong grounds, regards it as a symptom of depression, and recommends still more inflation (more government spending and tax cutting) to combat it. The Democratic platform itself condemns Republican efforts to curb inflation by raising the cost of borrowing as “the



first time bomb of the Republican crusade against full prosperity for all.”

If the American people vote for the Democratic candidate for President they will vote for a racing inflation leading to a crackup. ⚙

## The Economic Meaning

November 12, 1956

What is the meaning of the Eisenhower victory, and what, specifically, will be its consequences for American business?

It is not yet possible to answer these questions in simple or precise terms. In large part Mr. Eisenhower's reelection is an endorsement of a personality. It is significant that the chief campaign slogan this year, as in 1952, was “I like Ike,” not “I like Ike's policies.” In the four years since his first election, the President may have lost standing in the public mind as an administrator, but he has not lost stature as a man.

He has, indeed, even more deeply impressed the American people with his earnestness and integrity, his devotion to the national welfare, the national security, and world peace, and with his personal modesty and amiability. He has revealed in remarkable degree the Lincolnesque quality of “malice toward none, charity for all.” And this absence of malice has been especially felt by millions of voters who doubted that absence in Franklin D. Roosevelt or in Harry Truman. Mr. Eisenhower will go down in history as a magnanimous man, above personal spite or vindictiveness.

### WHAT MANDATE?

Has the President been given a “mandate” by the American people? And if so, what is that mandate? This question is difficult to answer because the issues in the last campaign were so many and so mixed. We will be nearer to an answer when there has been time to analyze the make-up of the new Congress, not only as regards the exact number of Republicans and Democrats elected, but the exact division between conservatives and radicals, between advocates of centralized power and advocates of states rights, between economizers and super-spenders.

But what is at least indisputable with regard to the Presidential vote is that, insofar as the American people had a choice, they voted for conservatism as against an extension of radicalism, and for a stable dollar as against still more inflation. Stevenson and Kefauver, as the campaign wore on, made it increasingly clear that they favored more government spending and interference,

more centralization of power and more socialistic measures in nearly every direction. The Democratic platform came out for income-tax cuts that alone would have reduced revenues by \$4.5 billion. Such a combination of increased spending and huge tax cuts would in itself have meant more inflation. In addition, the Democratic platform had denounced the so-called “hard-money policy” as “a time bomb . . . against full prosperity.” This meant that a Democratic Administration would have reinstated a cheap-money policy which could only have led at this time to a very dangerous inflation.

### AGAINST INFLATION

It is true that Mr. Eisenhower in the last four years has continued and even expanded many New Deal policies. But he has also refused to continue some important New Deal policies—notably further Federal socialization of electric power. The reckless proposals of Stevenson and Kefauver forced the President in the latter part of his campaign more and more to emphasize his own comparative conservatism.

It is quite possible, therefore, that Mr. Eisenhower's policies in his new term will become more conservative. He will doubtless continue to respect the independence of the Federal Reserve Board, and will continue to view with concern any development that threatens further erosion of the value of the dollar.

This is the interpretation most likely to be put on the election results by most businessmen. If that assumption is correct, they will go ahead with their current plans. Business confidence, insofar as the election results play a part in it, should continue high in the immediate future.

But even if Mr. Eisenhower does not become more conservative than he has been in the last two years, the Republicans in the new Congress, if they wish their party and their record to be meaningful, will resist the pressures for further expansion of Federal powers, big spending, inflation, and increasing governmental control over our lives. ⚙

## They've Had It

November 19, 1956

In *Newsweek* of July 30 and Aug. 6, I wrote two columns questioning the main assumptions of two articles by Harry Schwartz in *The New York Times* of June 25 and 26. The theme of these articles was that: “An economic race whose outcome could decide the fate of the world is in progress. The leaders of international



Communism expect to win the contest by beating capitalism at its own game—production.”

It is of course important not to underestimate Soviet military power. But there is an equal danger of paralyzing resistance to Russian Communism by gross exaggeration of that power. Admiral Radford, chairman of the Joint Chiefs of Staff, has testified that “defense hysteria” has led to precisely such gross exaggerations.

Even Russian steel output, which gets first priority because of its military need, has not been too impressive. In a study for the National Bureau of Economic Research, published last May, G. Warren Nutter pointed out: “[Russian] output of steel ingots in 1913 . . . was the same as that which had been reached in the United States in 1890, 23 years earlier. In 1928, Soviet output lagged 36 years; in 1940, 35 years; and in 1954, 38 years. The recently announced Sixth Five-Year Plan would, *if realized* [my italics], reduce the lag behind United States steel production to nineteen years . . . [or only] four years smaller than in 1913.”

#### ‘BREAD AND LIBERTY’

When we come to *overall* production, including civilian, the Communist claims of “beating capitalism” become ludicrous. I pointed out in my earlier articles that there was no good reason for supposing most Soviet statistics to be trustworthy. Reasons for doubting the Communist production boasts have now become overwhelming. For a time the Soviet leaders were able to cover their failures by plundering occupied countries. We can only guess how desperate the plight of the Hungarians must have become to drive them to their heroic revolt, and to their poignant twin demands for “Bread and Liberty.”

Meanwhile specific light has been thrown on production in Poland. On Oct. 16, the Warsaw newspaper *Trybuna Ludu* acknowledged that Communist Poland’s claims to industrial improvement in the Stalin era were mostly myths. “In industrial development,” this Communist Party organ admitted, “we are about ten years behind the chief European capitalist countries and about 30 to 40 years behind the United States.”

#### GOMULKA’S PROPOSAL

Then on Oct. 20, Gomulka, Poland’s Communist leader, made some jolting confessions before the Central Committee of the Polish Communist Party. The country, he said, faced a serious inflation. Collectivization of agriculture had been an expensive failure. Individual peasant farms yielded 16.7 percent more produce to the acre than collective farms, and 37.2 percent more to the acre than government-owned state farms. The failures of the collective farms, he continued, had been concealed. “The imbecility of agricultural policy . . . brought ruin to many an individual farmer.”

The situation in industry was certainly no better. Productivity in the coal industry in 1955 was 12.4 percent under that of 1949, though Polish coal miners had been forced to work 93 million hours overtime. Some of the machines and installations Poland was forced to produce, he said, “[had] so far found no application in production and will not find any such application for years to come.” Two million persons were working at unneeded tasks, and still there was large-scale unemployment.

When Gomulka came to housing, he pointed out that in the six-year plan since 1950 Poland had built only about 40 percent of housing needed for mere replacement. And then the bombshell “The insufficient amount of building materials could be overcome *by resorting to private enterprise*.” (My italics.)

For the last decade Americans have been bombarded with the cliché that if they do not continue to pour their money into the “underdeveloped” countries those countries “will turn in desperation to Communism.” Now we see nations that were forced into Communism trying to turn in desperation to private enterprise. ☼

## Mathematical Economics

November 26, 1956

In his fascinating four-volume anthology, *The World of Mathematics* (reviewed in *Newsweek* of Oct. 15), James R. Newman has chosen, as his two outstanding examples of the use of mathematics in economics, excerpts from the works of Cournot and Jevons. He has chosen wisely. These are the two outstanding pioneer works upon whose fundamental postulates practically all current mathematical economics is based. If these postulates are unsound, the whole towering structure of mathematical economics is built on sand.

Mathematical economics today enjoys immense academic prestige. Open at random almost any issue of, say, *The American Economic Review*, and your eye will probably fall on an unintelligible maze of algebraic symbols, differential equations, and diagrams and graphs full of crisscrossing curves. Open almost any “advanced” or even “elementary” college textbook on economics today and you will find the same thing, interspersed with contemptuous references to mere “literary” economists—i.e., economists who manage to get along without an ostentatious arsenal of x’s and y’s, ordinates and abscissa, big Deltas and little d’s.

## FUNCTIONS AND CURVES

Then read Cournot and Jevons, and you will find that our contemporary mathematical economists tacitly accept the same underlying postulates, and have since added practically nothing but elaborations. Cournot, more than a century ago (in 1838), was already writing such sentences as: "Let us admit therefore that the sales or the annual demand  $D$  is, for each article, a particular function  $F(p)$  of the price  $p$  of such article." And he was also explaining how "a curve can be made to represent the function in question."

Cournot's work seemed so strange and abstruse that it languished in neglect for 40 years. It was not until 1871, when William Stanley Jevons once more applied mathematical methods in his *Theory of Political Economy*, that mathematical economics began to be taken up in earnest. Today it is a virulent epidemic.

It is precisely because Jevons was bolder (and rasher) in his claims than Cournot that it is easier to detect his unproved or invalid assumptions. The subject is far too basic and intricate to argue in this space, and I am compelled to fall back on citations from authorities. In 1875, the eminent British economist J.E. Cairnes, commenting on Jevons's work, declared: "So far as I can see, economic truths are not discoverable through the instrumentality of mathematics. If this view be unsound, there is at hand an easy means of refutation—the production of an economic truth, not before known, which has been thus arrived at."

## 'A FIGURE OF SPEECH'

Cairnes's challenge has remained unanswered. But as he was not himself distinguished as a mathematician, his objections have been disregarded. Yet Paul Painlevé, a mathematician of the first rank, in his introduction in 1909 to the French translation of Jevons's work, denied the usefulness or legitimacy of mathematical methods in economics except in a quite "humble" and "occasional" role. He pointed out that "the assimilation of the laws of economic equilibrium to the principles of static mechanics" was no more than "a figure of speech."

The most uncompromising and compact refutation of the postulates of mathematical economics has been made by Ludwig von Mises: "The subject matter of economics is not potatoes, shirts, or razor blades," he points out, "but human action, which is directed by value judgments. A judgment of value does not measure, it grades. It does not say  $A$  equals  $B$ . It says: I prefer  $A$  to  $B$ . Only out of such choices does action come into being. Production and exchange do not result from equality of value, but from value difference. Therefore, in the field

of human action, there is no unit of measurement and no measuring. Prices are not measured in money; they are expressed in money."

Most mathematical economics, in short, rests on invalid assumptions. Businessmen make use of statistics, of course; but they pay no attention to the hypothetical equations and curves of the mathematical economists, who are playing with a false analogy and a wonderful toy that diverts their attention from real problems. ❁

## Two Kinds of Inflation?

December 3, 1956

It is reassuring that the President has expressed concern about inflation. Unfortunately his remarks reveal the same misunderstandings that have led to the worldwide continuance of inflation.

He falsely distinguished between "two types" of inflation. "One is just cheapened money, deficit spending . . . and printing money . . . that naturally brings rising prices because the money itself is cheaper." This increase in money supply is the real cause of inflation.

But the President went on to describe what he thought was another type of inflation: "There are also the rising prices brought about by the efforts of all people to gain a bigger portion of the results of our great productivity. Finally you get to the point . . . where you cannot attract money, capital investment money, that will build the factories that give . . . 67 million people their jobs, because lying behind every job in America is an investment of . . . \$15,000 to \$17,000. That money has got to be accumulated. . . . If you raise prices . . . too rapidly in one area, say the labor area, then prices go up, and finally you get to a point where you simply can't keep things in order." He ended by expressing confidence that there would develop "business and labor leadership that is sufficiently wise and farseeing to help solve this problem and keep it within bounds."

## TOO MANY DOLLARS

It is, of course, highly encouraging that the President recognizes the need for industry to earn enough profits to make possible more capital investment. This constantly increases productivity and hence real wages. It is equally encouraging to find him urging unions to refrain from excessive wage demands.

The truth, however, is that there is only one real type of inflation and only one direct economic cause. That cause is an increase in the supply of money and credit. It is the oversupply and the cheapening of the monetary unit that raises prices.

This does not mean that wage rises brought about by union pressure are irrelevant. They are often links in the full chain of inflation causes, though they are neither necessary nor sufficient in themselves to bring inflation. If unions raise wage rates excessively, and there is no increase in the money supply to make the payment of these higher wages possible, the result will not be to bring inflation but simply to bring unemployment. The chain of causation is then: Higher wage rates—higher costs—higher prices—lower sales—lower employment.

### WHO'S RESPONSIBLE?

Net unemployment can for a long time be averted or postponed, however, by a sufficient increase in the volume of credit. In this case the chain of causation is: Higher wage rates—increased borrowing from banks to meet larger payrolls—an increase of bank deposits as a result of this borrowing—consequent increase of the money-and-credit supply leading to still higher prices—still further demands for wage increases, etc.

It is precisely here that the responsibility of government for the whole inflationary process becomes clear. If the government had the courage to stop the increase in the money-and-credit supply (chiefly by allowing interest rates to go up), then the only result of excessive wage rates would be unemployment, and the only cure for the unemployment would be to reduce these wage rates back to an equilibrium level.

But hardly any present-day government has the political courage to take this step. Worse, most governments, like our own, build up (through their own equivalents of the Taft-Hartley Act, the Norris-LaGuardia Act, the Walsh-Healey Act, and the minimum-wage law) a situation that encourages excessive wage-rate demands and makes it next to impossible for employers to refuse them. That is why inflation today is worldwide.

Yet every government talks as if inflation were an epidemic beyond its own control. It piously asks labor, business, and consumers to exercise restraint—after it has itself removed the penalties for lack of restraint. As one candid “full employment” zealot confessed in *The London Economist* more than five years ago: “Inflation is nine-tenths of any practical full employment policy.” ❁

## For the Rule of Law

December 10, 1956

At least one aspect of the Middle East crisis, particularly as it affects the Suez Canal and the oil supplied to the West, falls within the province of a business column.

This is the importance not only to the interests of the United States, but to world trade, world investment, and world peace, of maintaining respect for international law, particularly as it affects the security of private property.

The situation in this respect has become richly ironic. It was Nasser himself who on Nov. 21 pledged himself “to the strict observance of all the international law which now exists,” and even called for “the expansion of international law to meet the needs of the complex modern world.” Yet the clearest possible case of breach of international law is one nation’s unilateral violation of a treaty to which that nation has itself been a signatory.

The Egyptian Government was not only a party to the Convention of 1888, it renewed its determination to uphold that convention as recently as October 1954. And that convention provided “for the benefit of all the world that the international character of the canal *would be perpetuated for all time*, irrespective of the expiration [in 1968] of the concession of the Universal Suez Canal Co.” Nasser couldn’t even wait for 1968. He seized the canal on July 26, only six weeks after the last British troops (partly because of American pressure) left Egyptian soil.

### CONDONING SEIZURES

What was even more remarkable in all this, however, was the failure of the United States and even England clearly to denounce the arbitrary seizure of an *international* agency and the private property of *foreigners* as a violation of international law.

As pointed out in this column of Aug. 27, the American Government in the last twenty years has piled up an amazing record of condoning other governments’ expropriations of foreign-owned private property (including that held by Americans). We in effect acquiesced in the seizure of the British and American oil properties by Mexico, and of the Anglo-Iranian oil properties by Iran. But the British were also prevented from taking any firm stand against the so-called “principle of nationalization” because of their government’s own home record in nationalizing coal mines, railroads, and communications.

It has remained for a few German writers to take the clearest stand on this issue. I have already (*Newsweek*, Aug. 20) referred to Wilhelm Röpke’s pamphlet on *Economic Order and International Law*. One German writer who has been particularly active in this field has been Hermann J. Abs, at Frankfurt-am-Main, financial adviser to Chancellor Adenauer, and head of



a new organization called the Society to Promote the Protection of Foreign Investment. Abs recognizes how vitally important it is for world peace and world recovery to restore the protection that international law, until the last quarter century, afforded to private property. He declared in Cologne on March 27:

#### TO PROTECT INVESTMENT

“Without the guaranty that invested capital will remain the investor’s property, bear interest, and be repaid in due time, it will be impossible to mobilize sufficient private capital for foreign projects. It must not be forgotten that private capital both in Europe and the United States has sufficient opportunities to work profitably at home without having to assume the additional risks regularly connected with foreign investment. . . . What is the use of international rules of law, of property-protecting clauses in Western constitutions, national laws and numerous commercial treaties . . . if they are not unreservedly observed in practice?”

Abs went on to recommend “the conclusion of an international Magna Charta, by which if possible all countries in the free world engage to respect and protect rightfully acquired foreign property and other foreigners’ rights. By this Charta, the contracting parties should submit to sanctions determined by an international arbitration court in the case of proven violations of this fundamental government. Perhaps it might be suitable for the Magna Charta to embody general basic rules concerning the fair treatment of foreign investments.” ☸

## Foreign-Policy Myths

December 17, 1956

The possible consequences of the Middle East crisis now overshadow all other economic factors. Any discussion of the American business outlook that ignored this crisis would be fatuous. As long as the crisis lasts or grows, a world oil shortage, raw-material shortage, and shipping shortage will last or grow. And so will inflationary pressures.

We got into this crisis largely because our foreign “policy” since the second world war has been a mish-mash of specious slogans, fallacious economic ideas, and pseudo-idealistic assumptions with no counterpart in reality. Among the pillars of this policy have been (1) the reiteration that every step we take must be “short of war”; (2) the program of giving away money and goods to foreign governments all over the globe almost

regardless of their internal or external policies; and (3) an announced determination to “act” only through the United Nations.

The consequences of these policies are becoming appallingly clear. The gratuitous announcement by the President that he could not “conceive of military force being a good solution” to the Suez problem, and of Secretary Dulles that the U.S. did “not intend to shoot our way through” the Suez Canal, assured Nasser and the Russian leaders that they could commit any aggression or barbarity without fear of reprisal.

#### BLACKMAIL TO NASSER?

The foreign-aid program has violated every sound economic principle. It has drained America of more than \$50 billion of resources. Abroad it has encouraged, subsidized, and prolonged every form of socialism, neutralism, and even anti-Americanism. The huge blackmail we offered to Nasser to help him build the grandiose Aswan Dam (which Egypt needed “as much as another pyramid”) is only one example of the fantastic lengths to which our foreign giveaway program has gone.

Finally, we come to the fetish we have made of the U.N. Here we have been like children bewitched by Tennyson’s vision of “the Parliament of Man, the Federation of the world.” We have acted as if such a dream could be realized merely by setting up machinery, erecting a plate-glass building, and calling the result the “United Nations.” The adjective has become a mockery.

What is no less ironic is that British and French statesmen (who spoke of our “saber rattling” and dangerous belligerency whenever Secretary Dulles used such phrases as “massive retaliation” or “brink of war”) are, now that they are faced with realities, appalled at their success in talking us into timorous appeasement and “action only through the United Nations.” British and French statesmen at last see with crystal clearness that to refer crucial problems to the U.N. is to evade responsibility and invite paralysis. As Anthony Eden has put it: “If we renounce the use of force when law cannot command order, then we are in fact undermining the rule of law. We are leaving the world open to the lawbreakers.”

#### ‘EVERYONE OR NO ONE’

Supplementing this, Christian Pineau, the French Minister of Foreign Affairs, in a speech before the U.N. on Nov. 22, presented a devastating history of the paralysis of the U.N. “each time there has been opposition between the Soviet Union and the West.” Contrasting the U.N.’s intervention in Egypt with its military and



moral impotence in Hungary, Pineau declared that if “the democracies alone must bow before the recommendations or the decisions” of the U.N., “the time would soon come when public opinion in those countries, would no longer agree to participation under such conditions. *The U.N. must decide to impose its decisions on everyone, or resign itself to impose them on no one.*” Its “very existence,” he warned, may be at stake.

Before irreparable harm has been done, let us hope that we in America will stop putting our conscience and decisions in the hands of other nations, and stop throwing away American principles and Western civilization by turning every critical problem over to the hazards of a vote by African, Asian, and Communist blocs.

Until we have steered our way out of the present world crisis, our economic outlook will remain obscure. ❁

## When Do We Stop?

December 24, 1956

Suppose a friend stood by while a thug snatched your bankroll; then urged you to negotiate a compromise with the thief; next called a policeman only to restrain *you* after you had seized the thief to get your money back, and finally offered to share your losses himself if you would promise to stop threatening the thief. What would you think of your friend’s friendship—or of his mental balance? Yet this is pretty close to the policy we have followed with the French and British. A devastating analysis of our foreign political blunders by Hans J. Morgenthau, director of the University of Chicago Center for Study of American Foreign Policy, recently appeared in, oddly enough, *The New Republic*. “When we heard spokesmen for the government,” wrote Professor Morgenthau, “propound the legal and moral platitudes which passed for foreign policy in the inter-war period, we thought this was the way in which the government tried to make the stark fact of foreign policy palatable to the people. . . . We were mistaken. These platitudes *are* the foreign policy of the United States.” He went on to point out how our “renunciation of force . . . actually increases the risk of atomic war”; and how the subordination of our national policies to the U.N. “makes it well-nigh certain that the enemies of the U.S. will make the terms of the [Middle East] settlement.”

### FOREIGN AID FOREVER

Let us turn now to some of the economic consequences of this policy, particularly to the new foreign-aid offers that our government has been so freely making. Whether

it was wise or necessary for the British Government to ask the U.S. to cancel \$81.6 million and Canada to cancel \$22.2 million of interest payments may be doubted. But as the request has been made, it would be unwise of us to refuse it. The enormously larger aid being proposed, however, raises graver problems. If we are to pay for Britain’s losses from Suez, why not those of France? Of all Western Europe? Of Israel? Even of Egypt? How and where and when do we stop?

It is reported that the Eisenhower Administration will ask for more than \$4 billion additional foreign aid in the next fiscal year, and thinks “the key to future foreign-aid operations is a grant by Congress of authority to use funds flexibly and without too many strings.” It is reassuring, at least, to learn that Secretary Humphrey is skeptical about the value of another big foreign-aid program and that Senator Byrd is “opposed to any further continuation of foreign economic aid.” The more than \$50 billion of aid we have granted since the end of the second world war was not only a gross waste, it actually went to subsidize and prolong harmful collectivist economic policies. There is no good reason why Congress should grant still further discretion to the executive branch in this direction. The discretion the executive branch already has on foreign aid has been used without wisdom. It is dangerous for Congress to keep delegating and abdicating more and more of its constitutional responsibilities and its control over the purse.

### TO FREE THE POUND

The International Monetary Fund and the Export-Import Bank are both ill-advised institutions. Both give undue discretion to the executive branch. Both are political institutions which necessarily politicize foreign trade and investment. Now the fund has authorized Britain to draw up to \$1.3 billion against it. Britain may perhaps get, in addition, a \$500 million to \$600 million loan from the U.S. Export-Import Bank.

And these funds are to be used to subsidize the continuance of the thoroughly unsound policies of exchange control and artificial price support for the pound sterling. The so-called “dollar shortage” is caused by exchange control (i.e., by coercive overpricing of the pound and other currencies). The alternative is not another “devaluation” of the pound. It is to let the pound go free, like the Canadian dollar, and to support it, not by the police power, but by restoring confidence in the currency through sound policies. The only sound policies, as Canada has shown, are those calculated to attract both domestic and foreign private investment. The cure for the world’s economic ills is not more statism, but a return to free enterprise. ❁

## Forecasts for 1957

December 31, 1956

The economic future depends not only on the vagaries of nature, but on what two and a half billion people are going to think and do, individually and compositely. That future can therefore never be foreseen with certainty. But every businessman and worker is forced to base his producing and spending plans on *some* assumption regarding the future. Among the people best qualified to assess the business outlook are those who make a business of it. I have asked a group of prominent business forecasters to give me their estimates of the probabilities for 1957 or for the next six months. Here are the results:

*Martin R. Gainsbrugh, National Industrial Conference Board:* Business activity is still gaining momentum as the year ends. Four types of demand have pushed gross national product into higher ground each quarter: (1) consumer upgrading as well as rebudgeting, so that modest percentage increases in outlays for soft goods and services kept total consumption expenditures rising, in the face of a 10 percent decline in what was spent for the big-tag, durable goods, (2) a sharply accelerated rate of spending for plant and equipment by private industry, (3) further growth in the outlays of state and local units of government in response to ever-mounting population pressures, and (4) expanded markets for goods and services abroad. These should again contribute to expansion in 1957, excepting possibly private business investment. Our estimates of new capital appropriations prepared for *Newsweek* now show signs of decline. This may mean less capital spending six or nine months hence.

### 'ANOTHER BEST YEAR'

*The Conference Board Economic Forum's collective view:* Gross national product for 1957 may rise about 4 percent above the 1956 figure equally divided between price and volume. Rate of growth may decline in the second half, but a new offset may be emerging: Greater Federal spending *directly* for defense or economic aid or

*indirectly* through resuming rapid tax amortization of new defense facilities, particularly steel.

*Leo Cherne, Research Institute of America, New York:* 1957 will be another best year ever—and yet, very different from those which have gone before. The momentum of current high spending assures continued gains during the early months of the new year. But the zip of the sharp pickup, evident especially during the last quarter of the current year, will be missing. By spring and summer the boom will begin to look somewhat wobbly, hesitation more prevalent than bubbling optimism. The long succession of tight-money moves will make itself felt. Their cumulative effect will be particularly noticeable in construction, inventory policy, and consumer purchases of new cars and other durables. The one unpredictable element which may color all expectations is the developing crisis in Soviet satellite nations and any repercussions which may flow from spreading unrest or Soviet military actions.

### PRICES AND BUILDING

*Charles F. Roos, Econometric Institute, New York:* During the past year, industrial commodity prices have generally reflected an average 5 percent increase in hourly earnings, an average 3 percent increase in productivity or output per man-hour, and  $\frac{1}{2}$  of 1 percent decrease in average profit on sales before income taxes. Average hourly earnings will move up about 2 percent during the first half of 1957 and productivity about 2 percent. Because of increases in excess capacity, profits on sales are likely to decrease by about  $\frac{1}{2}$  of 1 percent. Hence prices are apt to be about  $\frac{1}{2}$  of 1 percent lower.

*Roy Wenzlick & Co., St. Louis:* Residential building in 1957 will be slightly under 1956, both in dollars and in number of units. In many communities the housing shortage has disappeared, and in all communities money is tighter and interest rates are higher. This will probably result in more than 900,000 new dwelling units for the year, but less than 1 million. The dollar value of new residential building will not be down by so large a percentage, as the buildings that go forward will average larger in size and better in quality. Total construction of all types will probably equal the dollar total in 1956. ❁



1957





## Overrule the 'Fed'?

January 7, 1957

On Oct. 22, Elliott V. Bell, editor of *Business Week*, made a speech before the American Bankers Association which deserved and has received much attention, not because it contained anything new, but because it supported, in an unusually lucid and plausible form, increasingly popular Keynesian theories concerning who should manage our managed money, and how. These theories lead in practice to a philosophy of perpetual inflation.

Bell's plan, in brief, is to subordinate the Federal Reserve Board to a "National Economic Council," which would "coordinate" all monetary and "basic economic policies" of the government under the President, "who would have final responsibility for its decisions, and for resolving conflicts on basic matters." As Prof. Walter E. Spahr has already pointed out, this proposal is substantially the same as that made by a research staff of the Committee for Economic Development in 1946. The CED group recommended that a central monetary authority under the President be created and "charged with developing and directing a unified program of fiscal, monetary, and price control action to maintain price stability and high employment."

Spahr has also pointed out that if the proposed Economic Council is to have "the responsibility of determining the basic economic policies of the government," even "Congress would be compelled to abstain from exercising the powers and responsibilities reposed in it under the Constitution. It would have to do what the council directed it to do. The President would become a dictator."

### INDEPENDENCE?

Bell declares that his plan "would preserve the independence of the Federal Reserve System." In contradiction to this, however, he questions "whether under present-day conditions the Federal Reserve ought to be able to . . . go counter to the economic policies of the national Administration." It is clear that the Bell plan would make the "Fed" impotent. If the Fed chairman, as member of the proposed council, wanted to raise discount rates, for example, and other members of the board (which would include the President, Secretary of the Treasury, chairman of the Council of Economic Advisers, "and other top-ranking economic policymakers") wanted to lower discount rates, they could simply *outvote* the Fed chairman, who would have to go along with their decision. The Fed's "independence" would become a bad joke, consisting in the freedom to be overruled.

"In no major country of the world today, except in the United States," Bell declared, "is there a central bank that can legally, if it wishes, tell the head of its own government to go fly a kite." Let us put aside the question whether the President is "head" of our government or merely its Chief Executive, subject to the laws of Congress and the decisions of the courts. The situation Bell describes, when you come to think of it, is precisely what the situation ought to be. His comparison is unfortunate. It reminds us of the atmosphere of perpetual monetary crisis, or of racing postwar inflation, in nearly every country today where the central bank *can't* tell the government to go fly a kite.

### ETERNAL BOOM

The experience of history is that, wherever the central bank is *not* independent of the government, the government is unable to resist the fatally easy course of financing its needs by borrowing from the bank. It is unable to resist the demands of pressure groups for higher wages, subsidies, price supports, and inflation. The government tries to "stabilize" the boom at its peak, and to prolong it to eternity. It turns the central bank into the central inflation factory. What keeps our own Fed relatively independent today is that its governors serve overlapping terms of fourteen years, and cannot be removed for refusing to inflate.

All proposals of the Bell type begin by asserting that "the state is responsible for maintaining the economic health of the community." But the irony of such pious assertions of "social responsibility," as the Guaranty Trust Co. has pointed out, is that they nearly always end by proposals for financial irresponsibility. ❁

## Still More Foreign Aid?

January 14, 1957

In asking for advance authority to commit American troops to "protect the territorial integrity and political independence" of any Middle Eastern nation against Communist "armed aggression" the President has taken an immense step forward in foreign policy. Yet Congress is still faced with an awkward problem. It is being asked to give much wider discretionary powers to a President and a Secretary of State who have ineptly used the discretionary powers they already possess.

Nasser's seizure of the Suez Canal was a breach of a treaty and an arbitrary seizure of an international agency. We failed to denounce it as such. Instead, we restrained Britain and France and called a futile "users" conference, whose conciliatory proposals Egypt

contemptuously rejected. When France and England in desperation took the only remaining action likely to protect the vital interests of the West, we called the U.N. Assembly into session in order to stigmatize them as "aggressors."

The President now seems to be proposing to do with American money and at the risk of American lives the very things which he prevented Britain, France, and Israel from doing with their own money and at the risk of their own soldiers' lives. If the withdrawal of British and French troops now leaves a power "vacuum" in the Middle East, it is a vacuum which our own policy helped to create. The President's new proposals are a great step forward. But they still, in several respects, fail to face up to realities:

#### U.N. WEAKNESS

1—The President's proposals deal with a possible future crisis rather than the crisis that now confronts us. He offers to send troops to defend nations "requesting aid, against overt armed aggression from any nation controlled by international Communism." But this fails to deal with the problem of "peaceful" Communist infiltration, or to meet clearly the problem of Middle East countries, like Egypt and Syria, that are already under the control of men willing to play with the Communists.

2—The President apparently still wishes to leave the problem of Egyptian-Israeli relations and of the Suez Canal to the United Nations, though that body has so far signally failed to solve either problem. The President's own speech, however, clearly shows how weak a reed is the U.N. to bind our destinies to: "The United Nations was able to bring about a cease-fire and withdrawal of hostile forces from Egypt because it was dealing with governments and peoples who had a decent respect for the opinions of mankind. But in the case of Hungary . . . the Soviet Union . . . has shown callous indifference to the recommendations, even the censure, of the General Assembly." What does this mean but that the United Nations is either a hollow fiction as a preserver of world peace, or merely a tool that can be used against the democracies but not against the Communist dictatorships?

3—The President's message strongly implied that we would act alone in using troops in the Middle East, and not with England, France, or other members of NATO. This would not only put an immensely greater burden upon us, in money and men, delay help, and risk defeat, but its very proposal must further arouse the suspicions and resentment of our allies. We have already, by the recent ambiguities and contradictions of our foreign policy, badly shaken the confidence of those allies.

4—We come at last to the question of foreign aid. The President wishes to continue such aid "for economic and defensive military purposes," and will ask authorization of a special discretionary fund of \$400 million for the Middle East. But how and to what effect will these funds be employed? Are we once more to urge money upon Nasser, to prop up the Egyptian economy that his own actions have done so much to disrupt? Are we to reimburse Syria for its action in blowing up the pipeline that runs across it? Or are we to recognize, at last, that the whole economic foreign-aid program is a colossal failure? Egypt will recover through restoring the Suez Canal traffic and tolls, and the Middle East generally through restoring the movement of oil, far more quickly than with U.S. Government grants. ⚙

## Ike's New Program

January 21, 1957

Mr. Eisenhower's State of the Union message is a curious document, praising free enterprise and government economy in general terms while recommending more government controls and special spending.

His discussion of inflation was typical. He admitted the government's duty not to become "profligate in its expenditures." But then he called upon business to "avoid unnecessary price increases" and upon labor to refrain from "wage increases that outrun productivity." He implied that, if these two groups do not exercise "self-discipline," the Federal government might be forced to return to price and wage controls.

The truth is that government policy, particularly fiscal and monetary policy, must bear nine-tenths of the responsibility for inflation. Businessmen could not get higher prices for their goods unless government policy provided consumers with more money to buy the goods. Labor could not get excessive wage rates without bringing about unemployment unless government policy pumped out enough new money and credit to pay higher wages and raise prices. And it is inconsistent for the government to ask unions to refrain from higher wage demands while it retains a network of Federal statutes which make it almost impossible for employers to refuse to yield to higher wage demands.

#### INVESTIGATING THE FED

The President went on to recommend creation of a commission to inquire into the "nature, performance, and adequacy of our financial system." Any assumption that such a group would consist of disinterested

“experts” without already-formed conclusions, and that they would discover hitherto unknown truths, is unrealistic. Once membership of the commission is known, it should not be too difficult to make a shrewd guess concerning its “findings.” We will be fortunate indeed if the proposed commission does not advocate “reforms” that would only make inflation easier.

But the most important immediate decision before Congress, even from the economic point of view, is still the President’s proposal for discretionary power to commit American troops to “protect the territorial integrity and political independence” of any Middle Eastern nation requesting aid against Communist “armed aggression.” This proposal seems to be a belated effort to correct the disastrous blunder the Administration made when it voted with Egypt and Soviet Russia in the U.N. to demand that Britain, France and Israel, as “aggressors,” withdraw from Egypt, and do so without any assurance whatever of a settlement of the Suez Canal problem or the problem of Egyptian-Israeli relations.

#### WHAT WE DID AT SUEZ

Had we kept out of the situation altogether (or had we at least insisted on a two-sided resolution for the withdrawal of British, French, and Israeli troops from Egypt at the same rate as Russian troops withdrew from Hungary), it is probable that the canal would now be under the control of the British and French, and that Nasser, instead of Eden, would be “discredited.” As it is, Nasser has become impossible; the canal is still blocked, huge oil reserves are cut off and in grave peril of falling under Russian control. The President seems to be proposing to try to do with American money and at the risk of American lives the very things he prevented Britain, France, and Israel from doing with their own money and at the risk of their own soldiers’ lives.

There is grave doubt, even so, that the lone-hand policy now proposed by the President is the best alternative left to us. A much better course might be our simple adherence to the Baghdad pact. In any case there is no need whatever to authorize a bigger and special foreign-aid program. Resumption of Suez Canal traffic and the enormously profitable oil production and oil flow will give the Middle East all the economic aid it needs. If Congress does feel obliged to give the President discretionary power to commit foreign troops abroad, that power should be as restricted and temporary as it can be made. There is no good reason why every foreign crisis should lead to more powers for the executive branch at the expense of Congress particularly when it is the executive branch’s blunders that have helped produce the crisis. ❁

## Where It Can Be Cut

January 28, 1957

A few comparisons for perspective: Average annual expenditures of the Hoover Administration (fiscal years 1930–33 inclusive), \$4.1 billion. Of the first Roosevelt Administration (1934–37), \$7.4 billion. Of the second Truman Administration (1950–53), \$55.8 billion. Of the first Eisenhower Administration, \$66.6 billion. In the coming fiscal year, \$71.8 billion.

The Korean war, let us remember, lasted three years and one month. All but that last month was fought under Truman budgets. The entire \$9.7 billion reduction that Mr. Eisenhower effected in total expenditures between the fiscal years 1953, and 1955 (\$74.3 down to \$64.6 billion) came out of the military budget (\$50.4 down to \$40.6 billion). Of the \$7.3 billion rise in annual expenditures since 1955, the major part is accounted for by increases in domestic “welfare” spending. No wonder Secretary Humphrey rebelled. “I don’t think,” as he put it, “that you can spend yourself rich.”

Disregarding other huge categories of spending, let us consider the proposal to spend \$4.4 billion more on foreign aid in the next fiscal year, on top of the \$55 billion or so we have already paid out for this purpose since the end of the second world war.

#### FUTILE ECONOMIC AID

Our so-called foreign “economic” aid program has from the beginning been based on a mishmash of political confusions and economic fallacies. Politically, it has not promoted good will or gratitude or stopped the growth of Communism. On the contrary, it has engendered suspicion of our motives precisely in the countries to which we have given most. Its effect has been actually to breed anti-American policies on the part of foreign governments eager to prove to their own people that their receipt of aid from us has not made them subservient.

We on our side no longer dare to ask for any political *quid pro quo* for our aid, or even to insist that the recipient governments follow sound internal economic policies. We are afraid of being accused of attaching “strings” or conditions—although without such conditions our aid must fail to achieve the only results that could justify it. In fact, by freeing foreign governments from making the internal economic reforms that would be necessary to assure and attract foreign private investment, our foreign aid has merely subsidized and prolonged inflation, Socialism, and repressive controls in the countries receiving it. Our “economic” aid has probably on net balance actually retarded recovery in the countries to which it has gone.



## OUR COSTLY SILENCE

The proposal for a still bigger economic-aid program merely serves to divert attention from the essential weakness of the rest of the Middle East proposals. Mr. Eisenhower declares boldly that we will now do in the face of every disadvantage what we did not have the foresight to do when we enjoyed every advantage. When Britain, France, and Israel only a couple of months ago were within a few days of controlling the Suez Canal, and protecting their treaty rights and the vital interests of the free world, we self-righteously joined Nasser and Soviet Russia to stigmatize them as “aggressors” and order them out. When the U.S.S.R. threatened to send “volunteers” to Egypt to enforce this edict, and when a hint from us that we would not tolerate this, and might even join forces with France and Britain to combat it, would have nullified the Russian threat, our Administration spokesmen were strangely silent.

Now that the French and British are out, now that we no longer have allies in possession of the area, or even a clear idea of how we would get our own troops into the area, Mr. Eisenhower wants us to warn Russia how firm we are going to be the *next* time. Having rebuked Britain for a go-it-alone policy, we blandly propose a go-it-alone policy for ourselves, in the same theater and to accomplish essentially the same objectives. The only difference is that having spurned NATO and our proven allies we now promise, in compensation, to submit ourselves once more as in Korea, to the trammels and frustrations of United Nations debate and consent. How great, by the way, *is* the alleged “moral force” of the United Nations? What did it accomplish in Hungary? ❁

## Must We Ration Credit?

February 4, 1957

In *Newsweek* of Jan. 7 I analyzed a proposal for a “National Economic Council” to overrule the Federal Reserve authorities. Perhaps so thinly disguised a destruction of the Fed’s independence need not be feared at this time. But another and more subtle threat to anti-inflationary policy seems all too likely to succeed, unless its real implications are recognized.

This is the proposal to restore “selective” or “qualitative” credit controls. It has recently come from Elliott Bell, Sumner Slichter, Walter Lippmann, and other sources too numerous to list. It was put forward a year ago in the President’s Economic Report, and also by Allan Sproul, then president of the Federal Reserve Bank of New York. It has the sanction of precedent.

Our government used “selective” credit controls at various times between 1941 and 1952. They are widely imposed today in Europe. But the results hardly warrant emulation. Selective credit control is merely one more step along the road toward a command economy. It leads logically back to investment control and to price control.

Selective credit controls *are*, in fact, government control of short-term investments. The pressure for them comes from special groups of borrowers who want to be favored at the expense of the rest. It comes from monetary managers who lack the courage to refuse such demands; who lack the courage to let general interest rates rise to the point where they will halt inflation. When the price of any commodity is held down by government control, the demand soon exceeds the supply, and the commodity is then rationed. Selective credit controls are merely government rationing of credit.

## DISCRIMINATION

To ration credit is, of course, to discriminate among would-be borrowers. The decision is thrown into politics and determined by political pressures. This has already happened. Buying a house, even if you can’t afford it, is considered so laudable that the taxpayers are forced to guarantee 95 percent of the purchase price for you. Buying a refrigerator to put into the house, or a car to get to work from it, is considered much less laudable, so that the terms on which the seller was allowed to extend credit even at his own risk were tightened or “liberalized” by bureaucratic decree. Buying shares in Wall Street (i.e., investing in large-scale industries that increase production and create jobs) is considered so antisocial that the government forbids the seller or the lender to accept less than a down payment of 70 percent of the full price.

Government “selective” credit decisions are made, in short, on the basis of popular pressures and prejudices. Even if the record were better than this, what are we to say of a system which gives a group of government bureaucrats power to encourage borrowing for one purpose and to discourage it for another; to decide that there should be a boom in industry X but that industry Y should be choked to death? The only reason why “selective” credit controls, here and abroad, have not proved intolerably disruptive is that (for reasons explained in this column of March 5, 1956) such controls seldom achieve their aims.

## PRECISE INSTRUMENT

It is possible to deal here with only one or two of the many arguments that have recently been put forward in favor of selective credit schemes. It is contended, for example, that “overall quantitative credit control” is

“a pretty crude weapon.” The truth is that it would be hard to conceive of a more precise and truly selective instrument for allocating the supply of real savings among creditworthy borrowers than overall market interest rates that are allowed to reflect the real conditions of supply and demand. It is nonsense to say that a general rise in interest rates hits only “the little fellow” and favors “the big corporations.” One might just as well argue that a general rise in wage rates hits only the little project and helps the big project. Any general rise in costs merely shuts off the marginal projects, regardless of size, that do not seem likely to earn the higher costs.

This is the meaning and function of free markets, in the price of loanable funds as in the price of raw materials and in wages. ❁

## Economic Doublethink

February 11, 1957

The late George Orwell coined the word *doublethink* to mean “the power of holding two contradictory beliefs in one’s mind simultaneously, and accepting both of them.” Has this power been acquired by the Eisenhower Administration? It might explain the budget, the Middle East policy, and the Economic Report.

Let’s begin with the budget. We are told by Administration officials that it is the tightest budget that could be presented to Congress, but that it should be cut. The President even told his press conference that “there are literally thousands and thousands” of individual items in the budget, and “anybody that is examining that seriously ought to find some place where they might save another dollar.” It did not seem to occur to him that it was the prior and primary duty of himself, the Budget Bureau, and others who actually put those thousands of items together to search out the possible savings that “anybody” ought to find.

### SPEND AND SPEND

When some congressmen did suggest that it might be unnecessary just now to tie an authorization for a special discretionary foreign-aid fund of \$200 million for the Middle East on to the proposal for unrestricted military authority, Mr. Eisenhower quickly intervened to say that separation or postponement of the foreign-aid authorization “would destroy what we are really trying to do.” But when he was asked at a press conference how the proposed \$200 million would be spent, he replied that he didn’t know, “because the only way I can find out exactly how to spend the \$200 million would be

through the medium of the Richards mission . . . which cannot leave until the resolution has been passed.” He insists on the \$200 million, in short, before the need for it has even been determined.

His new philosophy of spending is also puzzling. Though he is presenting the largest peacetime budget on record, with unparalleled nondefense spending, Mr. Eisenhower is not troubled, because the country is enjoying the greatest prosperity on record, and a growing country can afford to and must spend more to meet its growing needs. But suppose the growth were suddenly to stop? Suppose signs of a depression set in? Then the government *must* spend more. Asked about deficit spending as a cure for recession, the President replied: “You begin then to apply moderate means, and then more, and if it kept going, finally you would go into every single thing, and very quickly. . . . And there would be no limit, I think, to what should be attempted as long as it was constitutional.” There is, alas, no constitutional limit on deficit spending.

### THE ECONOMIC REPORT

The Economic Report is another example of doublethink. It repeatedly praises “our free economy”—and then goes on to advocate the extension of government controls in a score of new directions. It insists on “strengthening competition”—and then proposes a score of measures to protect small business, labor, and agriculture against the effects of competition. It insists that government “must exercise a strict discipline over its expenditures”—then advocates an expansion of most existing categories of spending, and adds entirely new ones for local-school and highway building.

“As long as the American people demand and, in my opinion, deserve the kind of services that this budget provides,” the President declares, “we have got to spend this kind of money.” This implies the existence of a sort of economic Fourth Dimension. Mr. Eisenhower forgets that the government has nothing to give the American people that it does not take from the American people. It has nothing to give the states and cities that it does not take from the residents of the states and cities. It has nothing to give Paul that it does not take from Peter.

Five years ago (Jan. 28, 1952) with Mr. Truman in office, I remarked here that the Economic Report was an unnecessary document, whose chief recommendations are or ought to be found in the State of the Union message or in the budget. “The rest consists mainly of giving ‘scientific’ and ‘economic’ reasons for what the President has done or wants to do for political reasons.”

Has the situation changed? ❁

## Cut to \$60 Billion Now

February 18, 1957

Sen. Margaret Chase Smith has called the Federal budget for 1958 “fantastic.” To appreciate just how fantastic it is, we may begin by comparing once more its proposed record-breaking peacetime “visible” spending of \$71.8 billion with the \$4.1 billion annual average in the Hoover Administration, the \$7.4 billion annual average in the first Roosevelt Administration, the \$55.8 billion annual average in the second Truman Administration, and the \$66.6 billion annual average in the first Eisenhower Administration.

But this is just a beginning. As Raymond Moley pointed out in *Newsweek* of Feb. 4, the government is spending huge sums which do not appear in the regular budget. In 1958, for example, it will be paying out \$14.4 billion from various trust funds, compared with \$9.4 billion in 1956 and only \$5.3 billion four years ago. And there are other “hidden” expenditures of billions.

### NONDEFENSE SPENDING

One favorite excuse for all this is that defense costs money. Let’s disregard defense expenditures for the last ten years entirely, therefore, and compare nondefense expenditures alone (in billions).

1948	\$21.1	1953	24.0
1949	26.3	1954	20.9
1950	26.4	1955	24.0
1951	21.4	1956	25.9
1952	20.9	1957	27.9

The President proposes nondefense spending for the fiscal year 1958 of \$28.5 billion. This is \$7.6 billion, or 36 percent, more than in 1954. It is, in short, the biggest paternalistic “welfare” spending in any country in the history of the world.

Administration officials have an uneasy conscience about all this. So at the same time as they recommend this immensely overgrown spending program they also recommend that it should be cut. But even under pressure from Congressional committees they decline to name any specific place where a cut can be made. Until they are ready not merely to generalize but to specify, their commendation of economy must be set down as merely lip service.

There will be no real economy until the government is ready to slash drastically or to halt entirely whole

categories of spending. And it is not hard to point out what some of these categories are. We may begin with expenditures that the Federal government should avoid on principle—e.g., the proposal of Federal aid for local school construction. (The economic fallacies and political dangers of this program were discussed in this column of Dec. 26, 1955.)

### WHERE TO CUT

Next we come to expenditures which, even if we admit that there is a case for the Federal government getting into them at all, are completely contraindicated in the midst of an inflationary boom like the present one. They can only increase inflationary pressures. These would include Federal aid for the grandiose interstate highway system, and mounting subsidies and other artificial stimulants for “low-cost” housing.

Next, we come to the proposal to spend a total of \$4.4 billion on foreign aid in 1958. Probably three-quarters of this amount could with advantage be stopped at once. Most of the net proposed expenditures of nearly \$5 billion for agricultural subsidies (mainly for supporting food prices above the market or rewarding farmers for not producing) represents huge and inexcusable waste. Veterans’ benefits for 1958 are scheduled at more than \$5 billion—\$570 million higher even than in 1955.

Clearly it is not a problem of knowing where cuts in the budget can be made, but of daring to say. It has been customary for years to treat our mounting military budget as sacrosanct; yet Congressional investigations, and the Hoover report, have exposed profligate waste.

When Mr. Eisenhower announced his \$72 billion budget for 1958, a few newspapers wistfully recalled his 1952 campaign promise to reduce spending to \$60 billion a year by 1955. But this \$60 billion goal, far from having become chimerical, could be achieved in the new fiscal year, to the great economic benefit of the nation. All that is needed is the political courage and will to achieve it. ❁

## Blaming the Public

February 25, 1957

To all those who are so justifiably concerned about the dangers of further inflation, the most dismaying development of recent weeks was an announcement by Mr. Eisenhower (in his press conference of Feb. 6) that unless business and labor imposed on themselves certain unspecified self-restraints, the government would have “to move in more firmly with so-called controls of some kind, and when we begin to control prices and



allocations and wages, and all the rest, then it is not the America we know.”

This statement, unfortunately, cannot be dismissed as a mere slip of the tongue. It was preceded by a distinct hint in the President’s State of the Union message that unless business and labor exercised “self-discipline” the government might be forced to return to price and wage controls.

#### FALSE REMEDY

It should not be necessary to point out at this late date that price and wage controls are a completely spurious “cure” for inflation. We need merely recall the words of Mr. Eisenhower himself, in his first State of the Union message on Feb. 2, 1953: “Direct controls, except those on credit, deal not with the real causes of inflation but only with its symptoms. . . . They have proved largely unsatisfactory or unworkable. They have not prevented inflation; they have not kept down the cost of living. . . . I am convinced that now—as well as in the long run—free and competitive prices will best serve the interests of all the people.”

The truth is that government policy alone—particularly fiscal and monetary policy—must bear practically the full responsibility for inflation. For the actions of private bankers, businessmen, and labor leaders that increase inflation are themselves encouraged by monetary policy.

The Eisenhower Administration is spending more “welfare” funds in more directions than any of its predecessors. It supports laws that continue to undermine the ability of private employers to resist union demands for excessive wage rates. It is artificially supporting farm prices. It is artificially stimulating an unprecedented housing boom. It has encouraged or permitted the country’s money and credit supply to increase by \$23 billions since it came into office. For an Administration with this record to turn around and blame private business and labor for the inflationary result, and to start disrupting production with price and wage controls, would be the height of irony.

The remedy for inflation lies wholly in a change of governmental policy. And it lies not in giving still more discretionary, arbitrary, or dictatorial powers to government bureaucrats, or still more discretionary powers (more “techniques,” “tools,” or “weapons”) to our monetary managers but, on the contrary, in taking away some of their present discretionary powers and obliging them to abide by fixed and predictable rules.

It must be pointed out once more that a free competitive enterprise system cannot function effectively in the face of constant uncertainty concerning what the monetary managers are going to do—particularly when

those managers may not even know themselves. The country is especially fortunate today to have at the head of the Federal Reserve Board a man who combines the rare understanding, integrity, and courage of Chairman William McC. Martin, Jr. But the political pressures put upon him are excessive. They could be substantially lessened, and the dangers of inflation similarly lessened, by changes in our monetary rules or laws.

#### RULES VS. DISCRETION

I suggest two: (1) Congress or the Federal Reserve Board could adopt a rule similar to that put into effect by the Bank of Canada last November, under which the discount rate is changed weekly so as to maintain a fixed margin of  $\frac{1}{4}$  percent above the latest average tender rate for treasury bills. (2) The legally required gold certificate reserves of the Federal Reserve Banks could be restored approximately to the former requirement of 35 to 40 percent instead of the present “war emergency” requirement of only 25 percent adopted in 1945. Our controllers will not control inflation until they accept controls on themselves. Meanwhile they should stop scolding the American people. ❁

## No Boom Lasts Forever

March 4, 1957

The English-language edition has just appeared here of an important and illuminating book—*Common Sense Economics* by L. Albert Hahn (Abelard-Schuman, \$4.50). In addition to being a brilliant refutation of some of the chief fallacies of Keynesian economics, it includes one of the most persuasive discussions of the business cycle, as well as the shrewdest theoretical analysis of price formation on the stock markets, that I have ever read.

But the reader should be warned that the book is not, as its author seems to imagine, a simple introductory text—“a sort of minimum economics for the businessman.” For an introductory work Hahn’s exposition is much too technical, condensed, and abstract. And though Hahn’s style is studded with incisive epigrams, his book is not on the whole easy to read, because his sentences are often involved and “Germanic.”

Yet readers who come to the book with an adequate theoretical background will value it highly. Its correctives are particularly needed at the present time, when nearly every government in the world, most notably including our own, is looking at events through Keynes-colored glasses, and assuming that the present inflationary boom can be continued forever, provided



only that the government will continue to spend and spend, inflate and inflate.

### PROPENSITY TO WORK

Hahn shows what is wrong with this theory and policy. "The propensity to work," he insists, "and not the propensity to spend, is the foundation of national income and wealth." No inflation, he points out, can be continued forever. The stimulus of any dose of inflation, no matter how large, must ultimately exhaust itself.

The government is then faced with a dilemma—or rather a trilemma. If it tries to deflate the money and credit supply back to where it was, it will bring on price collapse, unemployment, bankruptcies, and perhaps prolonged depression. Even if it decides merely to prevent the inflation from going farther, it may find itself in trouble. For during any prolonged inflation more and more people begin to act on the assumption that the inflation will continue. Many security prices and commodity prices, many wage rates, many ambitious building and other capital-investment projects, are based not merely on the existing inflation but on the belief in a still further inflation. When it is clear that an inflation has been stopped, these anticipatory prices fall. Overambitious investment plans are scaled down or abandoned. This creates what European economists call "the stabilization crisis."

### INFLATION A SWINDLE

If, unwilling to take the risk even of a stabilization crisis, the government continues to inflate (by cheap-money policies, housing subsidies, mortgage guarantees, farm subsidies, and even bigger spending), the boom may indeed be kept going longer. But it can be kept going only at an ever-increasing risk, not merely of a greater economic crisis at the end, but of a collapse of the nation's currency and credit.

And there is no assurance, even so, that continued inflation can keep a boom going up to this point, much less that it can guarantee continued "full employment." It can keep prices rising, but it cannot assure continuance of volume prosperity. The supposed magic of inflation, in fact, consists entirely in the maintenance of "the money illusion." Once that is seen through by all major groups, the boom collapses. Inflation is essentially a swindle and cannot be openly planned. Creditors increase the interest rates they demand to compensate for the expected further depreciation of the currency. Labor unions demand wage increases that outrun both price and productivity increases. Inflation can "work" only as long as prices keep ahead of costs and maintain profit margins. The moment costs run ahead of prices, the joys of the spree are over, and only the headache remains.

And the sad part is that the whole binge is seen to have been unnecessary. Reasonably full employment could have been maintained all along without inflation, by a sufficiently free and fluid adjustment of wage rates to prices and of prices to each other. ❁

## A 'Common Market'?

March 11, 1957

With a great flourish of trumpets, the leaders of six European nations—France, West Germany, Italy, Belgium, the Netherlands, and Luxembourg—announced on Feb. 20 that they had agreed on the creation of a European "common market" which would also include their overseas territories. The plan is to introduce gradually a single or common market among the six nations, without tariffs or other barriers.

Is this step really, as one newspaper called it, perhaps "the greatest step so far toward the economic and, eventually, the political union of Europe?" There are strong reasons to doubt it.

1—The proposed lowering of tariffs among the participating nations will take place only over a period estimated at from twelve to seventeen years. The caution is understandable; but it recalls previous planned "transitional periods" (such as that envisaged by the International Monetary Fund) which somehow never seem to come to an end.

2—If the proposed common market were ever to become a reality, it would of course have the internal advantages of a customs union (like the German *Zollverein* of 1833). But it must remain meaningless until the six nations either adopt a gold standard, or abolish exchange controls and import quotas and make their currencies freely convertible into each other in any amount. This cannot happen as long as the currencies of the six countries remain on a paper basis, and have only a limited and controlled convertibility into each other at purely arbitrary valuations. As long as the currency of any one of the six nations is undervalued or overvalued at its "official" price, and as long as exchange controls and import quotas are continued, the so-called "common market" will be a sham, a hollow rhetorical phrase. The same criticism will apply, of course, as long as agricultural commodities are excluded from the "common market."

3—This European "integration" is something that the dispensers of American foreign aid, most notably Paul G. Hoffman, have been urging for several years. But it is a little hard to understand just what advantage

it will be to the Italian and French motor industries, for example, to continue to be able to keep out American competition but to be forced to accept full German competition—to be able to keep out the Ford say, but not the Volkswagen.

4—One of the mysteries of the whole episode is the paternalistic pressure which our government has applied to bring about the proposed European “common market.” If the United States were urging an all-round reduction of tariffs, or were itself planning to become a member of a free Western world common market, our government’s attitude could be understood as an acceptance of the general advantages of free trade—of cheaper imports for our consumers and wider foreign markets for our exporters. But we advocate this as a medicine good for Europeans but not for ourselves. We intend to maintain our own tariffs against the products of the six nations. We give our blessing to a “common market” from which we are to be deliberately excluded. And we will probably be called upon to finance the scheme, directly or indirectly, just as we put up the \$350 million kitty for the misconceived European Payments Union.

5—If such a common market would be good for the six nations involved, why wouldn’t it be good for all nations—or at least for all nations under free governments?

#### A PROSAIC SUGGESTION

The idea of universalizing the common market helps to bring out the main flaw in the plan as it stands. If each nation, simply acting individually, were to put its currency on a sound basis, abolish exchange control and quotas, and start reducing its own tariffs, all the real benefits of the proposed common market, without its drawbacks, could be universally achieved—and without the necessity of elaborate intergovernmental agreements or supranational statist controls.

But the suggestion that each nation put its own house in order is doubtless too prosaic. It would merely enable the world to catch up with the currency stability and the relative freedom of international trade which was accepted as a matter of course, say, back in 1913. ☸

## Are Unions Necessary?

March 18, 1957

The testimony before a Senate committee that high union officials used union funds to engage in organized gambling, bootlegging, and vice has produced some moral indignation—but not enough to lead to

any serious move in Congress for legal changes adequate to curb the immense irresponsible private power of unions, and of union officials over their own rank-and-file members.

Fortunately there is increasing evidence of a tendency in academic circles to challenge the century-old premises on which most present one-sided pro-union legislation is based. In a later article I hope to discuss at length two important new books—*The Labor Policy of a Free Society*, by Sylvester Petro, and *Why Wages Rise*, by F.A. Harper. But I should like to take up first a remarkable article which appeared in the September issue of *Encounter*, a monthly magazine published in London.

The title of this article is “Are Trade Unions Necessary?” Its author is Peter Wiles, a fellow of New College, Oxford. “In strict economics,” Wiles begins, “there is scarcely any case for the continued existence of trade unions in a fully employed welfare state.” He then runs through a whole series of traditional pro-union arguments, and starts knocking them down right and left. There is space to quote only a few excerpts.

#### SPIN OUT THE JOB

“Even in previous conditions of our society, trade unions may well have done more harm than good; modern social history is very sentimental, and handles them quite uncritically. . . .

“Shortening of the hours of work did little economic harm when the working week was 60 hours, and may even sometimes have increased actual production; it is certainly not harmless in the twentieth century when 44 hours is the standard working week.” (Forty hours here.)

“Full employment? But trade unions can only establish *fixed* employment, by making it more difficult for employers to sack labor—and even then they usually also make it more difficult for them to hire labor. . . .

“Again, trade unions can maintain what we may call unproductive employment, i.e., they can spread the work by resisting the introduction of labor-saving machinery or by making their members spin out the job in hand. These two measures are obviously worse than fixed employment; indeed from the economic point of view they are simply crimes. . . .

“Even if it be admitted that collective bargaining keeps down profits, or increases the general share of wages in the national income, this is not a good thing at all. For it hits investment, since a firm only desires to install machinery if it is profitable, and most of the finance for such things comes either from its own or someone else’s profits. And without investment

economic growth is slowed down. . . . A really severe cut in profits would stop progress altogether. . . .”

### CLOSED-SHOP RESULTS

“Of course, collective bargaining is a potent source of injustice in the distribution of income. It is truly amazing that anyone should suppose this crude, selfish, violent, and piecemeal process to contribute to social justice. . . . All that collective bargaining can ensure is that some workers do better than others. . . .

“The closed shop is about the worst threat to liberty in modern Britain. . . . It is a terrifying example of the moral blindness of this post-Christian, post-Liberal age that men have been driven to suicide because a union sent them to Coventry. . . . What grosser tyranny is there than that? . . .

“It is not only a question of persuading the trade unions to be reasonable over this or that. Economic reasonableness contradicts their very nature, their history, and their deepest inclinations. . . . The question is trade-union abolition.”

The final sentence does more honor to Wiles’s courage than to his judgment. It is an infringement of individual freedom for government to abridge the right of voluntary association. But it is surely the government’s duty to protect the individual worker against *compulsory* association, and it should certainly stop *forcing* employers exclusively to “recognize” and “bargain with” any particular union, no matter how unreasonable its demands or conduct may be. ❁

## How to Cut Spending

March 25, 1957

Nearly everyone, including the President, who proposed it, seems to agree that the \$72 billion budget for the fiscal year 1958 should be drastically slashed. But when it comes to any specific spending program, some special interest is sure to cry out that it cannot be touched. The President himself gave an amusing illustration of this in his press conference of March 7. A friend out West had written to say he “was very much upset about the size of the budget,” but in his last paragraph expressed the hope that there would be no cut in drought relief. Yet in this very conference Mr. Eisenhower, while he told how he was asking every government agency and department to suggest cuts in its own spending, expressed grave concern about proposals to make any substantial cut in foreign aid.

The situation suggests that there is only one feasible political device to get substantial cuts in the 1958

budget. This is for Congress *to tie every cut it makes in expenditures to a specific tax cut*. Only in this way can Congress dramatize the connection between expenditures and taxes, and offset the special political interest in favor of an expenditure by the interest of taxpayers in favor of tax relief.

### CUT FOREIGN AID

Let us take, as an example, the foreign-aid program. The public and Congress now express mounting doubts about the need or wisdom of that program. The recent Fairless report, certainly, does nothing to dispel these doubts. It merely reiterates all the question-begging generalities that have passed for argument in the last ten years. It mentions once in passing that about 2,000 separate foreign-aid projects are annually authorized in Washington, but makes no “detailed program examination” whatever. It does not even list the countries that are still receiving aid from us. (There are 54 of them, not including our dependencies.) Yet the program involves not merely appalling waste, but positive mischief.

Sen. Mike Mansfield has estimated that a \$3 billion annual cut could be safely made in the sums that our government has been spending abroad. It would seem advantageous to cut at least \$3 billion out of the \$4.4 billion that the President proposes to spend in the fiscal year 1958 for foreign military and economic aid. Out of appropriations left over from past years, the government will have at least \$3 billion to spend for foreign aid in 1958 even if Congress does not appropriate an extra penny. Congress, therefore, need make no appropriation at all for foreign aid for 1958. It can simply recommend that spending for this purpose be limited to \$1.2 billion in 1958, and tie this recommendation up with a tax cut of \$3.2 billion.

### 50 PERCENT TAX CEILING

There are any number of places, of course, where such a tax cut could advantageously be made. I suggest, by way of illustration, a cut in the normal personal income tax from 20 to 18 percent, and a cut of all personal income tax rates above 50 percent down to a 50 percent ceiling.

Roswell Magill, president of the Tax Foundation and a former Under Secretary of the Treasury, has declared: “If we could afford just one modest tax accomplishment in 1957, this 50 percent rate ceiling is the one which I should choose.” He estimates that the revenue loss would be about \$734 million, even without taking into account the probable increases in reported income as a result of the rate reduction itself. (The confiscatory



tax rates up to 91 percent produce little revenue. The basic rate of 20 percent accounts for 85 percent of the total yield of the income tax.) Cutting income-tax rates to a maximum of 50 percent would bring a sharp increase in American production, investment, and the availability of risk capital for new enterprises.

A cut in the normal tax from a 20-percent to an 18-percent would mean an additional loss in revenue of about \$2.4 billion; but it would also mean income-tax relief and increased incentives for everyone.

Any attempt to oppose or veto such a tax cut in order to maintain foreign-aid expenditures at their present level would bring home to the American people what foreign aid is really costing them. Other tax cuts could be tied to other spending cuts, with similar educational results. ❁

## Irresponsible Budget

April 1, 1957

The buck-passing between Congress and the President as to which one's duty it is to slash the \$72 billion budget, and how and where, not only darkens the hope that much real reduction will finally be achieved, but emphasizes once more that we will never get real economy until we set up a genuinely responsible budget system. What we have today is mere window-dressing, a make-believe budget system.

Under such a mock budget it is impossible to fix responsibility. The House can plausibly pass a resolution, as it did, requesting the President to "indicate the places and amounts in his budget where he thinks substantial reductions may be best made." It's his budget. He and his executive departments and agencies put it together. His Budget Bureau approved it. He recommended it. He himself has admitted that "there are literally thousands and thousands" of individual items in the budget. It does seem grossly unfair to put the burden of passing upon each of them on a body of 531 men, each of whom must pass upon hundreds of other questions.

Yet the President could also plausibly dodge responsibility by replying, as he did, that it was up to Congress to say which program "they don't want to carry out if they are going to make big savings." And this retort was supported by Cabinet members who pointed out: "We usually get more than we ask for."

### A WHOLESOME RULE

Responsibility is still further befogged by the Congressional habit of making appropriations for years ahead. It is estimated, for example, that the

Administration could spend at least \$3 billion more on foreign aid even if Congress failed to appropriate another penny for it. Responsibility is also hopelessly confused within Congress itself by the Senatorial habit of raising the appropriations of the House, and forcing an upward compromise, and by the Congressional practice of assigning appropriations to entirely different committees from those that must raise the money.

All of this would be impossible under a really responsible budget system. In Great Britain the wholesome rule has been established for more than two centuries that Parliament may reduce but not increase any spending recommendation made by the executive government. Under such a system the responsibility for the amount of spending, for a budget balance, and for the kind, rates, and yields of taxes, can be inescapably pinned on the executive.

### FOR AN ITEM VETO

Is it utopian to hope that such system could be established here? The practice in many individual states, certainly, gives no reason for despair. In New York State the governor's annual budget must not only give estimated expenditures and revenues for the next fiscal year, but must be accompanied by bills containing all the proposed appropriation and any proposed new taxes. The legislature (I quote the state constitution) "may not alter an appropriation bill submitted by the governor except to strike out or reduce items therein." If the legislature wishes to increase or add any appropriation, it must be by separate items or bills "each for a single object or purpose which 'shall be subject to the governor's approval.'"

In 39 states, in fact, the governor has the power to veto individual items in appropriation bills. Senator Byrd of Virginia two years ago proposed a constitutional amendment to authorize the President to veto any item in an appropriation bill. In 1937 a similar reform was urged by Republican Senator Vandenberg, and supported then by President Roosevelt. It is the very minimum step toward a responsible Federal budget.

It is not, of course, the only step. Hardly less important would be adoption of the recommendation of the Hoover commission that Congress stop appropriating enormous sums that may not be spent for several years, and appropriate money only for actual spending in a given year. A joint House-Senate budget committee, as recently recommended in the Senate, would also help. What is needed, in short, is a thorough reform in our fiscal procedures. Until we get such a reform, the outlook for real economy will not be promising. ❁



## Cotton Fiasco

April 8, 1957

Just how pernicious does a government subsidy or control scheme have to become before there can be any hope of getting rid of it?

The question keeps recurring in connection with the farm program. It is hard to realize quite how grotesque this program is until we examine it crop by crop. Let us look at cotton, for example.

The following quotation is condensed from a book published last year, *Farmers at the Crossroads*, by Secretary of Agriculture Ezra Taft Benson (as told to Carlisle Barger):

"The story of cotton is a tragic one. Becoming frightened at the problem of abundance, cotton farmers elected to live by rigid high price supports. What has been the result?

"Twenty-five years ago, cotton grew on 43 million acres of United States farm land. In 1956 the acreage is 17.4 million.

"Twenty-five years ago, before American cotton growers began to hold the price umbrella for foreign cotton producers, cotton production abroad totaled 12 million bales. This past year foreign production was 25 million bales.

"Twenty-five years ago the United States exported 7 million bales of cotton. During the past year our exports were 2 million bales.

"After 25 years of the utmost government solicitude, cotton has lost markets everywhere. Its producers have lost freedom. Cottonseed-oil supply is limited and soybean oil is increasingly taking its place. The pity is that the road back is a long, long one. Markets once lost are not easily regained."

### CONTINUED FOLLY

This may still stand as a pretty good summary of the present situation, except that, whereas cotton exports were only 2.2 million bales in the crop year ended July 31, it is estimated that they will reach 6.5 million bales in the present crop year. But it is ironic to call these figures "exports." They are simply the amount of cotton our government is now managing to unload on foreigners at a huge loss to the American taxpayer.

In the summer of 1939, as a result of the price-support program at that time, the government accumulated in storage some 11 million bales of cotton, equal to a full year's American production. The second world war came along and bailed the government out. So we continued the folly. In the summer of 1950, the government once more accumulated over 6 million bales of cotton. This time the Korean war came

to the rescue. We continued the folly. As the president of the New York and New Orleans cotton exchanges summed the present situation in a joint statement a few weeks ago before a Congressional committee: "In effect the program has resulted in subsidies to every foreign competitor of the American cotton farmer and textile manufacturer and in encouraging the development of artificial fibers which have rapidly increased in production to the disadvantage of every farmer.

### A WAY OUT?

Last year the government piled a more noxious subsidy on top of existing subsidies. This is the "soil bank," a subsidy for not producing. It differs only in name, not in substance, from the various acreage reduction and plow-under schemes tried out under Henry Wallace beginning in 1933.

Is there any way out? Some people in the cotton trade have suggested that the government loan level against cotton should be set only to "give protection in case of dire need." Other have recommended direct "compensatory payments" to cotton growers, but only against the amount of cotton consumed domestically, leaving all sales and prices to the open market. Either of these substitutes, at the start, would at least be less pernicious than the scheme we have. But, like it they would also probably prove self-perpetuating, and follow the same laws of malignant growth.

I should like to repeat a proposal put forward in this column a year ago. Let the government either give back the present cotton surplus to the growers who produced it, or sell it back to them at less than it would cost the growers to produce more. Then leave prices, production, consumption, any exports to the free market, and junk once for all the whole fantastic prices support and crop-restriction program. ❁

## The Vice Presidency

April 15, 1957

The decision regarding what should happen if a President is unable "to discharge the powers and duties" of his office can have crucial consequences for business. After studying the problem for three months the President and Attorney General have come up with a solution which seems to satisfy no one. If we break the problem into segments, in fact, it becomes clear that part of what they propose is unnecessary, and the rest inadvisable.

They propose a constitutional amendment to provide, first, that if the President were disabled and realized it, he could delegate his powers to the Vice

President and could resume them when he had recovered. But this could be done by a short and simple law under the Constitution as it stands. The relevant provision (Art. II, Sec. I) is only 83 words long:

"In case of the removal of the President from office, or of his death, resignation, or *inability* to discharge the powers and duties of the said office, the same shall devolve on the Vice President, and the *Congress may by law* provide for the case of *removal*, death, resignation, or *inability*, both of the President and Vice President, declaring what officer shall then act as President, and such officer shall act accordingly, *until the disability be removed*, or a President shall be elected." (My italics.)

### A POWER OF CONGRESS

This provision is said to be vague concerning what or who determines Presidential "inability." But it explicitly gives Congress power to decide all such details by legislation. If Congress, therefore, under this provision, explicitly authorized the President to transfer the powers and duties of his office temporarily, it is inconceivable that the Supreme Court would hold that Congress had acted beyond its constitutional powers.

The constitutional amendment proposed by the Attorney General, however, would go farther, and provide that if the President were disabled but unable to delegate his powers (in the event of a stroke or insanity, say), the Cabinet could decide by majority vote to have the Vice President assume the President's powers until the President stated in writing that he was resuming them.

Now this proposal would put a crucial decision in the hands of mere Presidential appointees. And as it would require a constitutional amendment to do this in any case, it raises the question whether we should not, while we are at it, go farther and abolish the office of Vice President altogether.

If anyone besides the President himself is to have the power of relieving him of the duties of his office, even temporarily, it should clearly be Congress. Congress, in fact, already has this constitutional power under the impeachment provision. Following that precedent, a new amendment might provide for a President's removal for disability by a majority vote in the House confirmed by a two-thirds vote in the Senate.

### FIFTH WHEEL

One way of solving the problem of who should succeed the President in case of his disability or death would be to abolish the office of Vice President, and give Congress the power to choose the President's successor; but with the provision, say, that if death or disability occurred before the Congressional mid-term elections,

a new Presidential election would be held at the same time as those elections to fill the unexpired term.

There are many possible variations on such a plan, and they would need to be carefully considered. But there is certainly nothing novel in the proposal to get rid of the wholly unnecessary office of the Vice Presidency, and to let the Senate choose its own presiding officer. As long ago as 1803, the Vice Presidency was compared to "a fifth wheel to a coach." Yet, as John Quincy Adams wrote in 1841, it can place "in the Executive chair a man never thought of for that office by anybody."

To remove the problem from all personal or partisan considerations, no proposed constitutional amendment on the subject should become effective before the election of 1960. Meanwhile Congress should by simple law authorize the President temporarily to delegate his powers and duties to the Vice President. ❀

## No One Is Responsible

April 22, 1957

The efforts of the President and Congress to pass on to each other responsibility for cutting the 1958 budget do not provide an encouraging spectacle, but they do provide an instructive one. They emphasize more than ever that we do not have a responsible budget system. There will be no real economy until we get one.

There are glaring inconsistencies both in the statements of the President and in the actions of Congress. Just before the Republican convention of 1952, Mr. Eisenhower expressed the opinion that the Federal budget could be cut as much as \$40 billion in the next few years. In October of 1952 he declared: "My goal, assuming that the cold war gets no worse, is to cut Federal spending to something like \$60 billion within four years." In the same month he said:

"We must find a substitute for the purely temporary business of bolstering the free nations through annual handouts. That gets neither permanent results nor real friends." Also in the same month (speaking of an annual budget of \$70 billion) he said:

"We can't afford what we're spending and stay strong enough to lead the world to peace." But now he declares, deploring even diminutive cuts in his own \$72 billion budget: "If we are going to wage peace abroad, and try to provide the leadership and the services at home that our people demand, then we have got to pay for it."

### IGNORING ITS OWN LAWS

Congress, in its Reorganization Act of 1946, provided for joint meetings of the tax and appropriations committees of both houses at the beginning of each session

to draw up a legislative budget for the ensuing fiscal year. Since 1949 it has completely ignored its own legislation on this point.

Buck-passing regarding economy would not be possible if we could once establish a responsible Executive budget system. Under such a system the Executive not only presents an itemized list of all proposed expenditures, but of all proposed changes in taxes necessary to meet those expenditures. This budget is accompanied by bills containing all the proposed appropriations and any proposed new taxes. The Legislature has the power to strike out or reduce expenditure items in such a budget, but not to add or increase any.

This rule against legislative increase has prevailed in Britain for more than two centuries. Under such a system budget responsibility is inescapably fixed upon the Executive. But he gains great advantages in compensation. The President, for example, would know in advance that Congress could not destroy courageous economies by making lavish appropriations of its own to pressure groups. If the President is sincere in his professed desire for economy, he will recommend a constitutional amendment to Congress, now, to create such a responsible budget system.

CONGRESS AS WATCHDOG

And if Congress on its side is sincere in desiring economy and a really responsible budget, it will not hesitate to accept such a self-denying amendment. It will even draft and submit one, whether or not the President asks for it. Congress, too, would find great compensations for giving up the power to increase or add appropriations. Congressmen would no longer be hounded by constituents or lobbyists demanding more appropriations for their districts or their pressure groups. Congressmen could refer all such demands to the Executive branch, and they would surely exercise far more than now their power to reduce proposed expenditures. "There is no propensity of human nature more marked than jealousy of opportunities that one does not share." Instead of competition between the President and Congress in spending, there would be competition in economy.

Perhaps it is utopian to hope that Congress could be persuaded to deprive itself completely of the power of increasing expenditures beyond those asked for by the President. But it might be willing to go at least as far as the Legislatures of many states, and limit itself to power to add proposed expenditures only in separate bills, individually subject to Presidential veto. Congress should be the watchman of the Treasury. It can be

counted on to perform its duty as watchman only if it does not itself have access to the Treasury. ⚙

Britain's Is a Budget

April 29, 1957

Americans, groaning over their April 15 tax payments, must have read with a mixture of envy and incredulity the budget announced by the British Chancellor of the Exchequer on April 9. Here are we, confronting the largest peacetime spending plan in our entire history, and being told by the Administration that it is naïve of us to expect any tax relief this year. And there is Britain, planning to spend in the fiscal year 1958 less than in 1957, and giving appreciable tax relief to its own citizens.

Several important lessons can be drawn from this comparison. Suppose we begin by comparing the American and British budgets over the past eleven years. Let us compare, for example, the official estimate of expenditures, before the beginning of each fiscal year, with the actual expenditures made in that fiscal year. The following table is in billions of dollars for American fiscal years ending June 30, and in billions of pounds for British fiscal years ending March 31.

Year	American Expenditures		British Expenditures	
	Est.	Act.	Est.	Act.
1947	\$35.1	\$39.0	£3.89	£3.91
1948	37.5	33.1	3.18	3.21
1949	39.7	39.5	2.98	3.18
1950	41.9	39.6	3.31	3.37
1951	42.4	44.1	3.45	3.26
1952	71.6	65.4	4.20	4.05
1953	85.4	74.3	4.23	4.35
1954	78.6	67.8	4.26	4.27
1955	65.6	64.6	4.52	4.30
1956	62.4	66.5	4.56	4.50
1957	65.8	68.9	4.74	4.87

The first thing to be noticed is how close Britain's estimates of expenditures come to the actuality and how widely our own government misses. In the eleven years 1947 to 1957, inclusive, the furthest the British Treasury came from predicting the result was in 1949; it missed by 7 percent. Its average percentage error for



the eleven years was only 2.3 percent. Compare this with the American record for the ten completed years from 1947 to 1956 inclusive. (The actual 1957 result will not be known until the end of June.) For 1947 and 1948 the estimates missed by more than 11 percent; for 1953 and 1954 they missed by more than 13 percent. The average percentage error for the ten years was 7.62 percent.

It is true, of course, that the President must make his estimate of expenditures for a fiscal year almost six months before that year begins, whereas the British Chancellor of the Exchequer publishes his estimate about a week after the fiscal year has begun (and when it is definitely known what actual expenditures were in the fiscal year just closed). But even if we take the *revised* estimates of expenditures made by the President a whole year later, more than six months *after* a fiscal year has begun, his average percentage error turns out to be 5.52 percent.

#### WORTH DREAMING ABOUT

The basic reason for these differences is not that British Treasury experts can foresee the economic future better than ours can. The basic reason is that Britain has a responsible executive budget system and we have not. When the British Chancellor of the Exchequer presents the budget, he is presenting not a mere set of estimates or a hopeful guess, but a pledge, a program, and an overall bill. Parliament must accept or reject this as a unit; it cannot kick it around or simply disregard it. We could approach such a system here if Congress retained its power to reduce proposed expenditures but relinquished its power to increase them. New York and many other states have such a system. Even to give the President power to veto individual items in appropriation bills—a power for which Mr. Eisenhower has now asked—would help enormously.

The possible rewards of a responsible budget system to the American taxpayer are illustrated by Britain's latest budget. The British Government plans to spend £4,827,000,000 in the next fiscal year. This is only 23.4 percent more than it spent in the 1947 fiscal year. We are still planning to spend about \$71.5 billion in 1958, or 83.3 percent more than in our 1947 fiscal year. Now if we also were planning to spend only 23.4 percent more than in 1947, we would be planning to spend only \$48.1 billion in 1958—a saving of \$23.4 billion. . . .

Well, a responsible budget is at least worth dreaming about. ☼

## If Congress Means It

May 6, 1957

Admittedly the President's letter to Speaker Rayburn is in large part a political document, designed to pin responsibility on Congress rather than the President for the \$72 billion budget. When Mr. Eisenhower declares, for example, that billions of dollars of proposed 1958 spending are "unavoidable" because they are "rigidly prescribed by law," he forgets that such laws can be changed, and that he himself has already had four years in which to recommend changes.

Nor must some \$45 billion of proposed 1958 expenditures be treated as sacrosanct merely because they ostensibly "will support programs related to the protection of our country." Some of these programs—particularly those relating to foreign aid—may be wholly unjustified; others may conceal great wastes. In its duty to scrutinize and economize, Congress should not be too much intimidated by the President's sweeping declaration that "a multibillion-dollar reduction in 1958 expenditures can be accomplished only at the expense of the national safety and interest."

Yet the President's letter to Speaker Rayburn includes some statesmanlike proposals of the first importance. Congress cannot ignore these without raising serious questions about its own sincerity or judgment.

#### THE FOURTH DIMENSION

Mr. Eisenhower, for example, begins by acknowledging frankly a fundamental truth that a few of his recent statements have seemed to overlook: "I am sure many members of the Congress are as gratified as I am to note the growing awareness of private citizens that the dollars spent by the Federal government are in fact their own dollars, and that Federal benefits are not free but must be paid for out of taxes collected from the people." Amen. Federal funds do not come out of any Fourth Dimension. When the Federal government meets more "needs" through Federal spending, the individual taxpayer is able to meet fewer needs of his own out of his own earnings.

At the end of his letter, Mr. Eisenhower names ten "steps" that he strongly urges upon Congress. Although all these recommendations deserve consideration, some raise complicated issues. Limits of space oblige me to concentrate upon recommendations seven and ten. Step seven is of major importance: "Enact bills approved by the Administration to implement Hoover-commission recommendations, such as the authorization of appropriations on the basis of annual accrued expenditures," etc.



But step ten goes even farther. If adopted, it might enable the President to put into effect most of the other nine. This is the request to “grant the President the power now held by many state governors to veto specific items in appropriations bills.”

### THE ‘ITEM VETO’

This proposal, so far from being novel, has been raised in one form or another for nearly a century. It is a power already possessed by the governors of more than three-quarters of our states. It is essential to even minimal budgetary responsibility. It would be desirable, in fact, to go much farther, as do many of our states (as well as foreign governments). Congress might voluntarily relinquish the power to increase expenditures recommended by the President while retaining the power to reduce them. Only such a system could eliminate “pork barrel” appropriations. As the late Senator Vandenberg put it: “Congress long since learned that if you put a little something for each of the 435 Congressional districts in one appropriation basket, pretty nearly everybody will help carry the basket.”

There is no danger that the “item veto” would give the President excessive budgetary power. Congress already has an absolute veto, when it chooses to exercise it, on any appropriation proposed by the President. The “item veto” would not even give the President equal power of absolute veto over any expenditure proposed by Congress; Congress could simply overrule his veto by a two-thirds vote.

In place of competition in spending, what is needed is a system in which both the President and Congress have power to restrain the spending of the other. Only such a system can protect the taxpayers. ☼

## Unions and the Law

May 13, 1957

As a result of the revelations concerning Dave Beck and his Teamsters union, the Eisenhower Administration is asking for still further Federal statutory intervention in the field of labor relations—the public disclosure of union receipts and expenditures, especially regarding pension and welfare plans. But Prof. Sylvester Petro of the New York University School of Law, I am confident, would suggest first of all a simpler solution, which is to cease making labor unions and their agents immune from the laws against violence, coercion, extortion and fraud which apply against everyone else.

“No other private association,” writes Petro in his new book *The Labor Policy of the Free Society* (Ronald

Press. \$5), “has displayed so much corruption and arrogance as some trade unions have. No other private association has so habitually terrorized and exploited both members and nonmembers, or so institutionalized the practice of compelling persons to become members. The combination . . . is no mere coincidence. . . . Internal corruption in some trade unions and the external dangers to society posed by many trade unions can all be traced directly to compulsory, coercive practices.”

### FREE EMPLOYEE CHOICE

Petro has written what seems to me by far the best analysis of the law of labor relations that has yet appeared. This is because he has tried to think out the basic political and legal philosophy most consonant with a sound free society; because he has given great study and thought to the economic consequences of alternative labor laws and policies; because he is a student of the common law as well as statutory labor law; because he is thoroughly informed on current court and NLRB decisions; and most of all because he has an excellent legal mind.

Petro begins by examining the basic institutions of a free society—personal freedom, freedom of contract, and private property. He dismisses the specious contrast between property and human rights: “Property rights are human rights, and nothing else.”

The right of association is also basic. Trade unions must be protected in the free exercise of that right. But neither employers nor trade unions can be permitted to engage in violent, coercive, or fraudulent conduct. Action otherwise illegal is not made legal by concert. Unions have a full right to strike, peaceably, for higher wages or better working conditions. But they have no right to use violence, intimidation or coercion to prevent other workers from taking the jobs they have voluntarily vacated. Petro would legalize, for example, all mass picketing as a form of intimidation and a clear violation of the central principle of “free employee choice.”

### WHY WAGES RISE

There are several important problems in labor law that Petro does not seem to me to have fully solved or clarified. This is not surprising when one considers the inherent difficulties of the subject as well as the intemperate and confused thinking that customarily beclouds it. But his book is full of courageous and magnificent common sense, and throws a brilliant light on a hundred points. His attacks on certain features of the Taft-Hartley Act, on the Norris-LaGuardia Act, on President Truman’s seizure of the steel plants in the 1952 strike, on the

Supreme Court's argument that picketing is just a form of "free speech," and on the same Court's recent doctrine of pre-emption, are beautiful specimens of relentless legal reasoning. He calls in forthright terms for the abolition of the National Labor Relations Board, and the complete repeal of the Norris-LaGuardia Act. His book deserves to be widely quoted and studied for a long time to come.

As a fitting companion to the Petro book, I suggest *Why Wages Rise* by F.A. Harper (Foundation for Economic Education, Irvington, N.Y., \$1.50). Harper supplies the economic basis on which many of Petro's propositions rest. He proves by reasoning and statistics that wages rise because productivity rises; that productivity rises mainly through increased investment in equipment made possible by profits; and that labor unions do not and cannot, by themselves, raise the general level of real wages for the whole body of the workers. ☼

## Bipartisan Economy

May 20, 1957

A spirit of narrow partisanship exists in both major parties in Washington today which does not promise well for economy. The President began by presenting a record-breaking peacetime budget recommending unjustifiable additions and increases. Then he blandly suggested that his own budget should be cut, but that it was up to Congress to find out where to cut it. When Congress thought it had found a few places, the President suggested that such cuts would threaten not only national welfare but world peace. Nearly every department head has protested against the cuts made.

The Democrats, on the other hand, seem to be evenly divided between those who think Federal spending should be cut and those who think it is still niggardly. Adlai Stevenson, for example, holds that a budget of the magnitude of the President's "is the least we dare have," which implies that huge spending is necessary for its own sake. It is foolish, he thinks, for the Democrats to try to "out-Republican the Republicans on the issue of budget-cutting." In short, government economy should be considered exclusively a Republican goal!

### CAMPAIGN ORATORY

Then there is the "advisory council" of the Democratic National Committee, a strange group who seem to think that party policy should be set, not by the

Democrats in Congress, but by Democrats out of office. Their statement on economic policy blames inflation on "big business," instead of on the huge spending and cheap money which they themselves advocate. They declare that "small increases in wages are used as the excuse for large increases in prices." If those who signed this statement had been interested in the truth rather than in campaign oratory they could have easily found that since 1952 hourly factory wages have gone up 22.7 percent while consumer prices have advanced only 4.6 percent.

Fortunately there are in both parties responsible men sincerely interested in economy rather than in trying to pin the blame for its absence on the other party. They include Secretary Humphrey and Under Secretary Burgess, Senator Knowland and many other Republicans; and, among Democrats, Speaker Rayburn, Senator Johnson, and, outstandingly, Senator Byrd. It is true that it is hard to find detailed agreement concerning just where cuts should be made and exactly how much they should total. Individual proposals for total cuts have ranged from \$2 billion to more than \$6 billion. Even the larger figure may be too modest. If, for example, like the British, we were planning to spend in fiscal 1958 only 41 percent more than in the average of the four years 1947-1950, our new budget would be \$18.5 billion less than it actually is.

### THE BUDGET PROCESS

But it should not be hard to find agreement concerning just what reforms in budgetary *procedure* will do most to curb irresponsible spending. Most of these reforms are recommended in reports of the Hoover commission. A few weeks ago President Eisenhower called upon Congress to enact bills approved by the Administration to implement these Hoover-commission recommendations. He particularly emphasized "the authorization of appropriations on the basis of annual accrued expenditures." In addition, Congress should pass legislation to insure a more thorough and effective Congressional review and check of executive recommendations. And, finally, Congress should grant the President the power for which he recently asked to veto specific items in appropriation bills.

This last step, to be effective, would have to be put in the form of a proposed constitutional amendment. Such an amendment would, of course, have most chance to succeed if offered under bipartisan sponsorship—by, let us say, Senators Byrd and Knowland and perhaps others from both major parties. Procedural reforms that could

be effectively accomplished by simple legislation ought to have similar bipartisan sponsorship.

Only through bipartisan support is real economy likely. Such cooperation will incidentally prove better politics for those who adopt it than transparently partisan efforts to put the other party in a hole. ❁

Communist Crack-Up

May 27, 1957

A little less than a year ago, those who take Soviet boasts seriously were warning us that Communism might be about to beat capitalism “at its own game—production.” Since then the evidence has been unmistakable that, far from there being any “miracle” of Communist production, the lands behind the Iron Curtain are going through an economic crisis.

The most revealing recent study of Soviet production was in a paper presented before the American Economic Association by Prof. G. Warren Nutter of the University of Virginia and the National Bureau of Economic Research. Warning that we must depend on Soviet official statistics, “where a government with flexible standards of candor has exercised rigid control over the trickle of information it has allowed to the outside world,” Nutter presents tables to show that even on the basis of these official statistics production in Russia lags farther behind that of the U.S. in most basic industries than it did in 1913. His tables cover 37 industries in three benchmark years. I select comparisons for nine basic or representative industries:

Industry	Number of Years Lag		
	1913	1937	1955
Steel ingots	21	32	29
Electric power	13	21	16
Coal	45	49	47
Crude petroleum	14	26	34
Cement	19	33	32
Railroad freight cars	33	51	69
Butter	21	38	35
Boots and shoes	23+	44	44
Cotton fabrics	28	44	48
Median 37 industries	28	36	34

If we take steel ingots as an example, the above table means that the Russian production in 1913 was roughly

equal to the production achieved in the United States around 1892, or 21 years earlier; that the lag had risen to 32 years in 1937, and fell somewhat from that point to a level of 29 years in 1955. The comparison is even worse on a per capita than on an overall basis. For the 37 industries in 1955, the median lag in per capita output was 56 years.

A major sign of financial strain in the Soviet Union was the announcement by Khrushchev on April 10 that the Soviet Government had decided to “postpone” for twenty to 25 years the redemption of 260 billion rubles of bonds held by the Russian people. This proved once again not only that the Soviet leaders will repudiate their most solemn pledge, but that they are as contemptuous of their promises to their own people as of their treaties with the “capitalist imperialist” West.

HOW TO DECENTRALIZE

But the most striking evidence of a crisis in Russian *production* is Khrushchev’s radical plan for decentralizing control. He is planning to abolish most of the giant ministries in Moscow and to shift daily operational control to a separate “economic council” in each of 92 economic regions. This pays capitalism the flattery of partial imitation; but it obviously does not go far enough to be effective.

A far more promising step was taken last year in Poland, when Gomulka declared that “joining of collective farms is voluntary.” As a result, it is now announced, 85 percent, or all but 1,958 of the 12,500 collectives forced together in a decade of Communist rule, have been liquidated.

All that Russia now has to do is to allow such a return to relative economic freedom and quasi-private property not only in farming but in industry. Let the government give the workers and managers shares in their respective industries or plants, say, in proportion to their wages or salaries. Let the new shareholders or partners in each plant elect their own managing partner. Allow everyone to buy or sell shares as he chooses; to change his occupation; to buy or sell or produce or consume what he wishes. Free all wages and prices from government control. Let successful managers reap their reward in profit, and let the burden of losses fall on the unsuccessful managers. Allow and encourage competition. Establish security of private property. Stabilize the currency. Respect obligations and enforce contracts. The result will be an enormous increase in production—of the goods consumers want, and in the proportions they want them.

This, of course, will be capitalism. But the Soviet leaders should find no difficulty in accepting it, provided only they are allowed to call it Modern Socialism. ❁



## Perpetual Foreign Aid

June 3, 1957

The President's decision to throw the weight of his great military prestige behind his military budget might have been more effective had he not chosen to defend nearly every other segment of his budget with equal ardor. "No great reductions in it are possible," he declares, "unless Congress eliminates or curtails existing programs." If this merely refers to *some* programs, it is self-evident. But it seems to assume that any program, once started, must continue without re-examination forever.

And this assumption appears to be the chief reason for the continuance of the foreign-aid program. If we had not previously embarked on that program, and got everybody inured to it, and some public figure came along now and suddenly proposed that we give \$4 billion away next year to some 60 different countries, he would be thought to have taken leave of his senses. But as we have *already* handed out some \$62 billion on foreign aid since the end of the second world war, the burden of proof is assumed to be on those who would "desert our friends" now.

Let us begin, for example, with the arguments that attempt to belittle the size of the foreign-aid program. Its cost, declares the President, "amounts to only 5 percent of the budget." But the more extravagant the total budget, the smaller a percentage of it is any given sum. The \$3.8 billion proposed for 1958 for foreign aid alone is greater than the entire Federal budget in any fiscal year from 1922 to 1932.

### WHAT IT COSTS US

The most realistic way of measuring the present fiscal burden of foreign aid is to ask how much taxes could be reduced if foreign-aid spending did not exist. On the basis of estimates compiled by the Tax Foundation, I find that if no one were taxed at anything higher than a combined normal and surtax rate of 30 percent (which now applies to the income-tax bracket between \$6,000 and \$8,000 a year), the loss in revenue would be no more than \$3.5 billion. Anybody paying any higher personal-income-tax rate than this, therefore, can figure that the addition is what the foreign-aid program costs him personally.

An elementary point constantly forgotten is that it is impossible in practice to tell the difference in net effect between foreign "military" aid and foreign "economic" aid. When we pay for part of a country's defense, we free that much of its own funds to enable it to buy other things. When we give a country "economic" aid,

it has that much more to spend on its military establishment. This means that the constant distinction made between "military" and "economic" aid is of dubious practical importance.

### UNPROVED ASSUMPTION

Our military aid (which in 1958 would be some \$3 billion, or three-fourths of total foreign aid) rests on the unproved assumption that none of the aided countries can fully pay for its own defense. This assumption is implausible on its face. The President tells us: "Around the world we have provided our allies, over the past seven years, some \$17 billion in direct military assistance. Over the same period, the defense budgets of our allies have totaled some \$107 billion." The question naturally arises why these "allies" could not have increased their military budgets an average of 16 percent to pay for the whole of their own defense? A year ago (April 16, 1956) I pointed out in this place that whereas the U.S. was spending some 62 percent of its total budget on defense, thirteen of our principal "allies" spent an average of only 26 percent of their total central government budget on defense.

To claim that we are getting our own defense cheaper by paying also for part of 38 other countries' defense begs an enormous question. Generally speaking, countries that think they need us for allies continue to want common defense treaties with us whether we help to support them financially or not. Countries that think they do not need us for allies, but only that *we need them*, may of course consent to take our money. But we merely delude ourselves about what we are buying with it.

The case for foreign "economic" aid is far weaker than the case for "military" aid. But that is another column. ❀

## Private Foreign Aid

June 10, 1957

"Military" aid will account for about three-fourths of the total cost of the foreign-aid program. Yet a separate examination of "economic" aid may prove enlightening.

Even the heavy program proposed cannot be described as anything more than a token program. It would be a mere bucket of water in the great sea of poverty into which it was poured. The President tells us that "a billion free people . . . live in lands where the average yearly income of each man is \$100 or less." To the nineteen or so "new nations" in which these people



live he is proposing to give in total economic aid next year about \$1 billion. But this means \$1 a year per person—which, other things equal, would raise each man's annual income from \$100 to \$101. Will this 1 percent increase remove the specter of Communism? Will it meet what Secretary Dulles calls their "determination to raise their pitifully low standards of living?"

### CAPITALISM THE ANSWER

It is not by government-to-government token aid that these countries can fight their way out of their age-old poverty. It is not by the socialistic experiments to which they are resorting in their "determination." It is not by flirting with Communism or adopting it. They can fight their way out of poverty—and at what would seem a magical speed—by adopting the philosophy and methods which built this country up from a few pioneers, struggling with a few crude tools, to the richest and most productive nation that the world has ever seen. The leaders of the "underdeveloped nations" can also do this—by adopting free enterprise, by adopting precisely the philosophy of capitalism to which they are so hostile.

Capitalism is not, as the politicians of the "underdeveloped countries" suppose, mere "technical know-how," or the "application of mechanical power." These are among the *results* of capitalism, not its causes. Capitalism is a set of economic and political *principles*. It means freedom to produce and consume, freedom to buy and sell, freedom of contract, free prices, and free markets. With these freedoms it combines the institution of private property, under which a man is entitled to keep the fruits of his labor. It is these freedoms and protections that give so tremendous an incentive to production.

If the "underdeveloped areas" were to adopt these principles, they would immediately attract both domestic and foreign *private* capital for their own development. For then they would willingly give the minimum assurances necessary to attract private investment—guarantees to private property against nationalization, seizure, or excessive taxation; freedom to withdraw earnings or principal; freedom from vexatious regulations and controls generally.

### PRIVATE INVESTMENT

Some of us have been pointing this out with perhaps wearisome repetition for years (e.g., *Newsweek*, July 7, 1952). The case was admirably put a couple of months ago in a report by the American Enterprise Association. The thesis of the report is that, dollar for dollar, private foreign investment stimulates more economic growth than foreign aid; and that primary reliance on private enterprise rather than government-to-government aid

is more likely to produce an efficient and sustained rise in the welfare of the underdeveloped countries, as well as good political relations with the United States. Private foreign investment, in contrast to aid, the report pointed out, minimizes suspicion on the part of foreigners that ulterior motives are involved. It creates no sense of charity; it emphasizes mutual benefits; and it averts insoluble disputes concerning the intercountry distribution of aid.

The Administration's new plan does pay lip service to the potential role of private foreign investment. But it wishes to subordinate it to a government Development Loan Fund which as Secretary Dulles admits, would "take greater financial risks than those acceptable to existing institutions and would, in fact, be "primarily an instrumentality of foreign policy." This apparently means that foreign nations would continue to get loans by threatening to go Communist rather than by creating an attractive climate for private investment. ❁

## High Taxes vs. Yield

June 17, 1957

Our steeply "progressive" personal income taxes, as students of the subject have long recognized, undermine incentives and slow down the capital formation upon which our economic progress in the long run depends. But as a new 40-page study by the Tax Foundation proves in detail, these confiscatory rates do not even achieve their ostensible purpose of raising revenue.

If a flat rate of 20 percent (now applying only to the lowest taxable income bracket) were applied, for example, to all taxable income, 85 percent of the revenue at 1955 rates would still be obtained. This rate produced \$25.5 billion of the revenue from the personal income tax in 1955. All the "progressive" rates together produced only \$4.4 billion more.

Our extravagant Federal expenditures are in large part the result of the belief that "the rich" are paying them. This belief is a delusion. If the present rate structure were cut off at a maximum of 50 percent, 98 percent of the revenue at 1955 rates would still be obtained. (The loss in revenue would be only \$734 million.) If the present rate structure were cut off at a maximum of 70 percent, 99.5 percent of the revenue at 1955 rates would still be obtained. (The loss would be only \$145 million.)

### RATES VS. REVENUES

But even these relatively small losses are calculated on the assumption that income in the higher tax brackets

would not change. Yet the Tax Foundation's study provides a very heavy presumption that if the top rates were reduced as indicated, the incomes they affected would not only increase relatively to other incomes as a result of the incentives (or reduced deterrents) provided by the tax cut, but would increase enough actually to increase government revenues from these incomes.

Time and again, when the highest rates were reduced, relative revenues from the high-income brackets rose. During the 1920s the greatest reduction in surtax rates was at the top of the income scale (from 65 percent to 20 percent). Despite this reduction, the share of the total income tax paid by the high-income classes more than doubled—from 30 percent in 1920 to 65 percent in 1929.

The contrast is even more striking when we look at the steady long-term fall in the percentage of the total tax revenues collected from the higher incomes as the rate on those incomes was increased. Despite a huge increase in total personal incomes, we find that in the highest incomes (those of more than \$100,000) there has been no long-term upward trend in total income reported. In fact, *average* reported income per tax return above \$100,000 is actually less in recent years than in 1916!

### THE \$100,000 INCOMES

As neither official national income figures nor price indexes are now generally carried back beyond 1929, I take that year as our base of comparison. The national income increased from \$87.8 billion in 1929 to \$302.1 in 1953—a rise of 244 percent. The top surtax rates on incomes over \$100,000 were increased from 20 percent in 1929 to 74 to 89 percent in 1953. And the total income of those who filed income-tax returns over \$100,000 *fell* from \$4.4 billion in 1929 to \$2.9 billion in 1953, a decline of 33 percent.

Even this does not show the real contrast. For in 1953 wholesale prices had risen to an index of 110.1 as compared with 61.9 in 1929. This means that the incomes of \$100,000 and over in 1953 should in strictness be compared (in real purchasing power) with incomes of \$56,222 and over in 1929. As the Tax Foundation study does not make full allowance for all these factors, its conclusions actually understate its case.

The effect of high taxes on incentives to work and invest has been obscured, it is true, by nearly three decades of depression, war, and inflation. But it is enormously probable that cutting off the top progressive rates at a maximum of 50 percent (instead of the present merely punitive 91 percent) would lead to an actual *increase* in governmental revenues. If Congress can set aside all catering to prejudice and envy, and

courageously take this step, it will achieve a major tax reform without endangering a balanced budget. ☼

## Tax Reform Now

June 24, 1957

We are being warned from Washington that all hopes for tax cuts that would apply even to part of the fiscal year 1958 are vain and unrealistic. The tacit assumption on which all these warnings rest is that the proposed \$72 billion expenditure total for 1958 is sacred and untouchable, and might "have to be" even larger.

Let us, for the sake of argument, grant that the \$72 billion budget "can't" be reduced—or at least won't be. It is still possible to make, *now*, major reforms in our tax laws *that would not reduce revenues at all*.

We saw last week that if the present personal income-tax rate structure were cut off at a maximum of 50 percent, 98 percent of the revenue would still be obtained—even on the assumption that the drastic cut would do nothing to stimulate an increase in taxable income in the high brackets affected. But from the whole history of rate and revenue changes since 1916, as the Tax Foundation's study shows, it is enormously probable that cutting off the top progressive rates at a maximum of 50 percent (instead of the present merely punitive 91 percent) would lead to an actual increase in governmental revenues.

### DISCRIMINATIONS

Other major reforms could be made in the personal income tax that would involve only a negligible loss in revenue. One would be to reduce the present discrimination against irregular incomes. An inventor, novelist, or motion-picture actor may earn \$100,000 this year and nothing for the next three years. He would pay (if single) a tax of \$66,798. A corporation executive, on the other hand, with a \$25,000 income for each of four years, would pay a total tax on his \$100,000 of only \$39,184. Such discrimination could be greatly reduced by allowing a taxpayer to "average down" his tax for a certain number of years on the basis of his average annual income over the whole period.

There are half a dozen different ways in which the great injustices in the present capital-gains tax could be mitigated.

The corporation tax is another area where a major reform could be made without reducing revenues. At present, corporations pay a "normal" tax of 30 percent on the first \$25,000 of net income, and a "surtax" of 22 percent (or a total of 52 percent) on all net income above

\$25,000. This “progression” is quite unjustified. For a corporation earning \$25,000 may be wholly owned by one rich man, whereas millions of low-income stockholders in big corporations are paying nearly 52 percent on their share of the net income of these corporations (before paying their personal income tax). Yet nearly all the bills in Congress to change the corporate income tax would carry this grossly misapplied “progressive” principle still further, either by reducing the tax on “small business” or by levying confiscatory rates (up to 75 percent, for example) on big corporations.

### CORPORATE TAX CHOICE

There is a simple tax reform which would discriminate neither against sole proprietorships and partnerships nor against small corporations. This would be to make the corporate net income tax a flat 52 percent, but to allow any corporation the option in any year of paying the personal tax rate on net income instead. In practice (assuming present personal income-tax rates), this would mean that any corporation earning less than \$46,000 a year would find it advantageous to pay the personal rates (although the personal income-tax *bracket* between \$44,000 and \$50,000 pays 72 percent). This plan would mean a smaller tax than at present for all corporations earning less than about \$14,000 a year and a higher tax for others.

The net effect of such a change would be to bring in a higher total corporate revenue than the present system. This could be offset by allowing corporations a lower rate on the part of their net income that they paid out in dividends, in place of the present clumsy and confusing system of dividend credits for individuals.

These major tax reforms could be made immediately, to apply to income of the 1958 calendar year. They would not reduce revenues; they would remove inequities; and they would greatly stimulate economic progress. ❁

## The Great Swindle

July 1, 1957

A year ago (*Newsweek*, June 25, 1956) I printed here, under the above title, a table showing the depreciation, in terms of domestic purchasing power, of the currencies of 53 countries in the ten years from 1946 to 1955. This table had been compiled by Franz Pick. He has now carried it forward, for the nine-year period from January 1948 to December 1956, in the 1957 edition of his *Currency Yearbook*. I present the results below, showing the depreciation of 56 currencies in that period.

It is important to keep this appalling worldwide picture constantly before our minds. For it reminds us that inflation is nothing but a great swindle, and that this swindle is practiced in varying degrees, sometimes ignorantly and sometimes cynically, by nearly every government in the world. This swindle erodes the purchasing power of everybody's income and the purchasing power of everybody's savings. It is a concealed tax, and the most vicious of all taxes. It taxes the incomes and savings of the poor by the same percentage as the incomes and savings of the rich. It falls with greatest force precisely on the thrifty, on the aged, on those who cannot protect themselves by speculation or by demanding and getting higher money incomes to compensate for the depreciation of the monetary unit.

### WHY INFLATION?

Why does this swindle go on? It goes on because governments wish to spend, partly for armaments and in most cases preponderantly for subsidies and handouts to various pressure groups, but lack the courage to tax as much as they spend. It goes on, in other words, because governments wish to buy the votes of some of us while concealing from the rest of us that those votes are being bought with our own money. It goes on because politicians (partly through the second- or third-hand influence of the theories of the late Lord Keynes) think that this is the way, and the only way, to maintain “full employment,” the present-day fetish of the self-styled progressives. It goes on because the international gold standard has been abandoned, because the world's currencies are essentially paper currencies, adrift without an anchor, blown about by every political wind, and at the mercy of every bureaucratic caprice. And the very governments that are inflating profess solemnly to be “fighting” inflation. Through cheap-money policies, or the printing press, or both, they increase the supply of money and credit and affect to deplore the inevitable result.

The following table is based on official cost-of-living indexes, many of which understate the real extent of currency debasement. Russia and its satellite countries are omitted because disparities between actual and “official” price levels are so wide and the statistics are meaningless. The American dollar, to which so many other currencies are ostensibly tied, itself shows a depreciation of 15 percent in the period. The British pound sterling, the world's most important trade unit, lost 34 percent, the French franc 52 percent, the currencies of Chile, Paraguay, Bolivia, and Korea, from 93 to 99 percent.



## CURRENCY SHRINKAGE

Percentage Decline in Purchasing Power of Monetary Units  
January 1948–December 1956

Dominican	2	Norwegian	33
Egyptian	6	New Zealand	33
Portuguese	6	Spanish	34
Haitian	8	United Kingdom	34
Swiss	10	Thailand	35
Ceylonese	11	Turkish	36
Burmese	12	El Salvador	40
Dutch Antillean	12	Nicaraguan	40
Ecuadorian	13	Mexican	45
Pakistan	14	Colombian	46
Belgian	15	Uruguayan	48
United States	15	Finnish	49
Indian	15	Icelandic	51
West German	18	Australian	52
Venezuelan	19	French	52
Hong Kong	23	Japanese	55
Guatemalan	23	Austrian	55
Canadian	25	Peruvian	55
Italian	25	Greek	58
Honduran	26	Indonesian	59
Costa Rican	27	Israel	66
Irish	28	Brazilian	70
Malayan	28	Argentine	73
Danish	29	Taiwan	85
Swedish	29	Chilean	93
Netherlands	30	Paraguayan	96
South African	31	Bolivian	99
Iranian	33	Korean	99 ☸

## Easy Money=Inflation

July 8, 1957

Secretary Humphrey's defense of the Administration's economic record was an admirable presentation. It was also (what was not evident in the headlines) a lucid lesson on the causes of inflation, and one of the most impressive answers yet made to the advocates of cheap money.

The Secretary presented "a record of a prospering America with new high levels of employment, rising income, and increasing purchasing power." True, he had an easier time praising the early record of the Eisenhower regime than the later one, and under questioning by Senator Byrd made some qualifications not in his original statement. He admitted that the national debt had increased, not decreased, in the four Eisenhower years. When Senator Byrd confronted him with General Eisenhower's 1952 promise to reduce spending to \$60 billion, he made the political blunder of replying: "That was before he was elected." And he had no convincing answer when Senator Byrd pointed out that a slipping back only to the levels of national income of two years ago would result in a budget deficit of \$12 billion, or when the senator went on to express the belief that the "new inflation" that started last year will "in all likelihood continue and may, in fact, be accelerated."

But to one contention Secretary Humphrey did have a convincing answer. This is the contention of the inflationist that the Administration has been reducing the volume of credit, and causing "inflation" and higher prices by raising interest rates.

## HOW CREDIT EXPANDED

As to the volume of credit, the Secretary had no difficulty in showing that it has actually "expanded substantially in the last four years." "There is more credit outstanding today than ever before." In fact, as the Secretary pointed out, if we count mortgage, consumer, corporate, and other forms of nonbank credit, the total has *increased* over 1952 by the staggering sum of \$146.5 billion (\$135.8 billion from "savings" and \$10.7 billion "from bank credit expansion, or increased money supply"). The "tight money" complaint, as the Secretary showed, merely reduces itself to this—that the government has put some limits on monetary expansion.

And Humphrey gave the best official answer yet made to the frequent contention that an increase in interest rates raises prices because interest rates are a cost of production. On the basis of the gross sales of all manufacturers, he pointed out that of the cost of an article selling for \$100, about 33 cents represents interest. During the ten-year period since 1946 "prices of goods that consumers buy rose 27½ percent, or \$27.50 on a \$100 item [due to labor and other costs], compared with the 20-cent increase due to higher interest."

## INTEREST AS A COST

His comparisons in home-building were no less impressive. A house that cost \$10,000 to build in 1946 would cost \$19,000 in 1957. If the interest rate on an FHA mortgage increased from 4 percent in 1946 to 5 percent



in 1956, then the monthly mortgage payment (on the basis of 15 percent down and a twenty-year amortization) would increase from \$51.51 on the 1946 house to \$106.58 on the 1957 house. Only \$8.71 of this increase would be due to the higher interest cost; the other \$46.36 would be due to other costs raised by inflation.

But to hold down interest rates artificially is to encourage borrowing and thereby to increase the money-and-credit supply. It is this increased money supply that raises prices and constitutes the heart of inflation.

The real criticism to be made of the Federal Reserve is not that it has kept credit too scarce and interest rates too high, but that it has yielded to inflationist pressure. It has made credit too plentiful and kept interest rates too low. It is precisely because interest rates are too low that the demand for credit still exceeds the supply. A discount rate of only 3 percent (when 91-day Treasury bills yield 3.404 percent) is inflationary. The Fed might be well-advised follow the example of Canada, and keep the discount rate always at least  $\frac{1}{4}$  of 1 percent above the bill rate. This would also show that the Fed was merely following the market, and not arbitrarily raising interest rates. ❁

## Why 'Tight Money'

July 15, 1957

The report on June 26 of the subcommittee on Fiscal Policy of the Congressional Joint Economic Committee was obviously a political compromise. Like all such compromises it contained double talk; it said two mutually contradictory things at once.

It began by admitting that "the rapid expansion of Federal government spending . . . has contributed significantly to inflationary pressures." It had much to say about the need for economy. But: "At the same time, a number of soft spots in the economy emphasize the need for continuing alertness . . . which may require revisions in current public policies"—i.e., deficit spending and "relaxation of present general credit controls."

Now there are always "soft spots," even in the midst of the biggest inflationary boom. And if we are to abandon anti-inflationary policy the moment it shows signs of being effective, if the only flexibility we are willing to permit is in the upward direction, then we are in effect committed to a continuance of inflation. Stabilization after an inflationary boom is always painful. It necessarily brings some "soft spots," recessions in some industries. A stable "full employment" economy, with simultaneous full employment in all lines, and no

losses or soft spots anywhere, exists only in a Keynesian dream world. A policy aimed at maintaining constant full employment in every line, and with constantly rising wage rates, is a policy of inflation.

### A RARE MERIT

But the Congressional subcommittee report does have an outstanding and (in view of present political pressures and confusions of thought) a rare and unexpected merit. It does support the Federal Reserve's so-called "tight money" policy. It does declare that "public policies to cope with increases in the price level must take the form of general fiscal and monetary restraints on the expansion of total spending."

The report shows unusual economic sophistication. It throws proper doubt on the recent fashionable "cost-price push" theory of inflation: "Present inflationary pressures frequently are attributed to the so-called cost-price push, as distinct from the traditional inflation resulting from excessive demand. Whether or not the distinction is valid, it is evident that general price increases can occur without increasing unemployment only if demand is adequate to support the higher price level. The basic problem is an inadequate level of savings out of current income."

This is correct; but it could have been stated much more clearly and forcibly. The "excessive demand" that causes inflation means excessive monetary demand. Excessive monetary demand comes from excessive money supply. Excessive money supply is the result of increasing the supply of money and credit more than the supply of goods and services.

### MONEY VS. WAGE RATES

And the supply of money and credit is excessively increased whenever interest rates are held down by Federal Reserve policy below the level at which unhampered market forces would have fixed them. When interest rates are artificially held down by governmental policy, borrowing is over-stimulated; excessive money and credit are created through the banking system, and prices (including wage rates) are pushed up. This is the essence of inflation.

Expansion of the money supply is both the necessary and the sufficient cause of inflation. An increase in wage rates in neither a necessary nor a sufficient cause. Without an increase in the money supply, an increase in wage rates would lead merely to unemployment. Increased wage rates lead to inflation not through economic necessity but through political pressure. First the government sets up or retains a legal framework (the Norris-LaGuardia Act, Walsh-Healey Act, minimum-wage law, Wagner-Taft-Hartley Act) under which wage rates are forced up. Then there are pressures from every

side to give everybody the additional monetary means to pay for the goods and services at the higher prices made necessary by the higher wage rates.

We can stop this “wage-price spiral” the moment we have the economic understanding and the political courage to do so. ☸

## Cost-Push Inflation?

July 22, 1957

Within the last few months there has broken out in several places the theory that we are now confronted with a “new” kind of inflation. As described by Robert C. Tyson, chairman of the finance committee of the U.S. Steel Corp.: “Our new kind of inflation appears to be cost inflation pushing prices up, rather than price inflation pulling up costs through competition bidding for materials and manpower. We might think of it as a new cost-push type as distinguished from the conventional demand-pull type of inflation.”

Going even farther, a recent study of the National Industrial Conference Board declares: “Although money supply has been checkreined by Federal Reserve policy, business is still on the uptrend. . . . Since prices have continued to rise, the clear lesson of 1956 is that money and its rate of use are not the sole determinants of price. . . . Today, the critical question is: How adequate are monetary controls for coping with price pressures that arise from nonmonetary forces?”

### NO STATISTICAL PROOF

Now these theories seem to me to mix truth with error. The Conference Board attempts to prove its case statistically. But as the U.S. Bureau of Labor Statistics pointed out on May 13 in a study of productivity, costs, and prices: “Where the figures indicate that prices and unit labor costs showed about the same increase, or that one or the other showed a greater increase during a particular year or period of years, this should be taken as a description of what happened and not necessarily as an explanation of what ‘caused’ the change. An increase in unit labor costs may lead to an increase in price, but conversely an increase in price can result in strong pressure for increases in wages. . . . The answer to the question of whether the wage increases cause the price increase or vice versa cannot be determined from the figures alone.”

The BLS report goes on to declare: “Average hourly compensation [of workers] in current dollars increased much more than productivity during the postwar period [1947–56]. The former increased by about 61

percent, the latter by 26 percent, leading to an increase in employee compensation per dollar of real product of about 28 percent.”

This sounds ominous, but only because it is confusingly stated. Four paragraphs farther down the report declares: “The increase of about 28 percent in employee compensation per dollar of real product was almost identical with the increase in price between 1947 and 1956.” In other words, the word “productivity” in the first quotation must mean productivity in *real* terms, not in *dollar-value* terms. Multiply the 26 percent increase in “productivity” by the 28 percent increase in price level, and we get the same 61 percent increase as in hourly labor income.

### ANTICIPATIONS

The Conference Board tries to prove that the increase in the money supply cannot be the cause of the price rise in the last two years, because the money supply has not gone up in this period. But this overlooks longer comparisons, and mistakenly assumes that changes in money supply must reflect themselves exactly proportionately in prices with neither time lag nor anticipations. Expansion of the money supply is both the necessary and the sufficient cause of inflation. Without such expansion, an excessive increase in wage rates would lead merely to unemployment.

I regret having to criticize what are otherwise two excellent and informative statistical reports. And insofar as they describe *political pressures*, the “cost push” theorists are right. Our politicians put irresponsible and irresistible power in the hands of union leaders, and then plead with them not to use it. They remove the natural economic penalties for recklessness, and then beg for restraint. If the Federal Reserve seriously tried to hold the line on money and credit, while the union leaders kept pushing up wage rates, it is the Federal Reserve, not the unions, that the politicians would blame for the consequent unemployment and recession.

As long as the political climate remains this unhealthy, a halt to inflation is impossible. But with understanding and courage, inflation could be halted overnight. ☸

## Built-In Inflation

July 29, 1957

There are so many confusions of thought today concerning the causes and cure of inflation that in calling attention to one error one must temporarily ignore another. One is liable, as a result, to be accused of having fallen

into the error one has ignored. This is particularly true in any discussion of the respective roles that wage increases and monetary policy play in inflation.

In answer to the pure “cost push” theorists, I have pointed out that expansion of the money supply is both the necessary and the sufficient cause of inflation; and that without an increase in the money supply, an increase in wage rates would lead merely to unemployment. But while this generalization is essential to a correct theoretical understanding of what is now going on, it was never intended to be, and is certainly not, a comprehensive factual description of what is now going on. For if to the economic forces considered in isolation, we add political and institutional forces, we get a total picture of the present inflation in which wage increases play a crucial role.

### POLITICAL PRESSURE

And they play this role because of governmental policy. Governmental policy in this respect has done two main things: (1) Through special legal privileges and immunities, it has built up the power of unions and union bargaining to a point where employers can no longer resist excessive wage demands. (2) When these demands have been granted, excessive pressure is put on the governmental monetary managers to create the money and credit necessary to sustain the wage increase (and consequent price increases) without unemployment. Thus wage, price, and money-and-credit increases act on a ratchet or endless-chain principle to keep the inflation going.

And the “cost push” theorists are right in this—that the *political* pressure for inflation today comes from the desire to keep “full employment,” to encourage constant wage increases, and to make both possible by low interest rates and credit expansion.

When the Federal Reserve lets interest rates up to the point to which excessive demand tends to pull them, when it seriously tries to keep money and credit from further expansion, it is denounced for a “tight money” policy. It is accused of discouraging home-building, “small business,” or what not. When the steel industry raises prices to meet the higher costs necessitated by excessive wage advances forced upon it, senators denounce the price rise as inflationary, but are silent about the wage rise that caused it. The President pleads for “restraint” on the part of business and labor, forgetting the elaborate legal framework which has made union leaders all-powerful and left employers impotent to resist wage-increase demands.

### REAPPRAISAL NEEDED

We do indeed have a built-in inflation. And it is built in by governmental policy. Among its foundation stones

are the Norris-LaGuardia Act, the Walsh-Healey Act, the Fair Labor Standards Act, the Wagner-Taft-Hartley Act (and the mass of NLRB and court decisions), and the Employment Act of 1946. Under these laws the government has not merely encouraged but in effect forced the creation of industrywide unions with irresponsible private power to force continuous wage increases.

If the world were under a real international gold standard, with the natural penalties that this sets on excessive money-and-credit expansion, the result of these wage increases would be unemployment. But under nationally managed paper currencies the national managers everywhere are denounced for trying to sit on the lid.

There is no *economic* problem whatever to stopping inflation. It could be stopped overnight. But this would involve not only courage in the monetary field, but an “agonizing reappraisal” of the labor policy of the last 25 years that neither the Republicans nor the Democrats, as a party, have the courage to make. It is not merely that they do not have the courage to act. They do not have the courage to face the truth about the Frankenstein monster of uncurbed union power that they themselves have built. ☼

## Contradictory Goals

August 5, 1957

Last January the Guaranty Trust Co. of New York, in its monthly Survey, discussed a problem that has engaged the attention of leading European economists and is now becoming urgent here. This involves the clash in the economic objectives of governments which assume “responsibility” for the achievement of certain “goals.”

Our own government, for example, now follows Britain and France in pursuing three mutually contradictory aims. These are (1) constantly rising wages; (2) stable prices; and (3) full employment.

It should be obvious that these goals cannot all be achieved at the same time. Even in the short run, any two of these goals can be achieved only at the sacrifice of the third. Thus if we try to have constantly rising wages (regardless of productivity), we can have full employment only if we are willing to allow prices to go up to maintain profit margins, and only if we increase monetary purchasing power enough to enable consumers to pay the higher prices. But this is another way of saying that we must give up the goal of stable prices and encourage a continuous inflation.



If we try to have both constantly rising wages and stable prices, we can have them only at the cost of unemployment, and eventually of mass unemployment. If we want both stable prices and full employment, then the constant annual “rounds” of wage increases, as a result of strikes or strike threats (and regardless of what has happened to productivity), will have to be abandoned.

### CAN INFLATION CREEP?

But given the pressures from union leaders and other pressure groups, and given the prevailing obsession that government “must assume responsibility” for everybody’s economic welfare, the de facto choice of Western governments in the last decade or two has been constantly rising wages and full employment financed by a so-called “creeping” inflation.

There are not lacking, indeed, rationalizations of this very course, among the most candid of which is that of Sumner H. Slichter of Harvard. Professor Slichter seems to think that a “creeping” inflation of some 2 percent a year would be just fine. It has already been pointed out by Dr. Winfield Riefler of the Federal Reserve that, even if we assume we could control an inflation to a rate of 2 percent a year, “it would be equal to an erosion of the purchasing power of the dollar by about one-half in each generation.” The legalized robbery that such a “solution” would involve of millions of savings-bank depositors, life-insurance policyholders, bondholders, and of everyone dependent on a fixed or sluggishly responsive income, is itself sufficient ground for rejecting it.

### IT WOULD NOT WORK

But it would not even work. The moment an inflation is planned, acknowledged, and *foreseen*, the game is up. Inflation is a swindle. You cannot tell your intended victim in advance that you intend to swindle him. Slichter proposes his plan mainly in order to meet annual wage demands. But union leaders, if the plan were put into effect, would simply add 2 percent (or whatever the planned annual inflation was) on top of the demands they would have made anyway. In fact, lenders, investors, merchants, speculators would all mark up their demands or change their operations to beat the inflation, which, out of control, would race to a crack-up.

What is still understood only by an appallingly small minority even of the “experts” is that prices, in the early stage of an inflation, usually rise by *less* than the increase in the money supply, but in the later stage of an inflation always rise by *more* than the increase in the money supply.

Yet there is one way in which the three goals of rising wages, stable prices, and full employment (when these goals are properly understood) could all be achieved. This way is through the restoration of a sound currency and a genuinely free economy. In such an economy, it is true, wages could not for long rise faster than marginal labor productivity, but they would rise *as fast as* marginal labor productivity, though the rise in their real purchasing power might be reflected more in lower prices than in higher wage rates. ☸

## ‘Administered’ Inflation

August 12, 1957

Gardiner C. Means, an economist who invented the term “administered prices” in the ’30s, has come up with the theory that the current inflation is an “administered” inflation. The solution, he thinks, would be for the President to call a conference of business and labor leaders, and get an agreement from them to “hold the line” for a year or two on wages and prices. But his theory of causation is false; and his proposed remedy is not needed, would not work, and would greatly aggravate the very evil it is supposed to cure.

Past inflations, he agrees, have been “monetary” inflations—the result of an increased money supply bidding for the available supply of goods and services. This is correct. And it applies to *every* inflation, including the present one.

This can be shown by any set of long-term comparisons. At the end of 1939, the total supply of money and bank credit (total bank deposits plus currency outside of banks) was \$64.7 billion. In March of this year it was \$221.5 billion, an increase of 246 percent. In 1939 wholesale prices were at an index number of 50.1; today they are at a level of 117.4, an increase of 136 percent. The chief reason why wholesale prices have not gone up even more in this period is that there has also been a great increase in production. The increase in the money supply is a sufficient explanation of the present inflation. We do not have a “new kind” of inflation, and we do not need new explanations.

### ADMINISTERED BY WHOM?

Neither logic nor statistical comparisons give any support to the “administered price” theory of inflation. If sellers can administer prices to any level they choose, why weren’t prices as high in 1955, or 1949, or 1939, or 1914, as they are today? Why are prices all being raised now? What has prevented them from going still higher?



Certain prices, it is true, are administered (within narrow limits) at levels different from those that a perfectly fluid competition would bring about. The outstanding directly administered prices are those administered by government. This includes all public-utility rates and railroad rates. But these are administered down rather than up. Farm prices have of course been supported by government above free-market levels. Farm products have risen 150 percent since 1939, whereas industrial products have risen only 116 percent.

By far the most important administered price is the price of labor. Wage rates have been administered upward by powerful industrywide labor unions. Since 1939 hourly wages in manufacturing industries have increased by 229 percent.

### FALSE CURE

As a cure for all this, Means would have the President call a conference of business and labor leaders at which he would "get agreement from them to hold the line" on prices and wages. Now such agreements would be extremely harmful if they were uniformly adhered to. They would not allow for the relative changes in particular prices and wages necessary to adjust output to changes in supply and demand.

But all hold-the-line legislation or voluntary agreements in the past have broken down under political pressures, chiefly in favor of wage increases. The Means plan left-handedly recognizes this. His proposed agreements would allow "small" wage increases to take account of increases in productivity, and increases "where a major disparity in particular wage rates required correction." Anyone who remembers our second-world-war experience must know that such loopholes would be exploited to the point where the hold-the-line agreements would become a farce. But even this would be better than their strict enforcement. For to try to hold a uniform line on prices and wages, particularly if the money and credit supply continued to be increased, would have a disastrous effect on production.

And the scheme is wholly unnecessary. All that is needed to stop the present inflation is a halt to the expansion of money-and-credit supply and repeal of the legislation that creates monster unions and gives them a coercive wage-raising power that employers are impotent to resist. ❁

## Easy Money Has an End

August 19, 1957

When four Federal Reserve Banks raised their discount rates as of Aug. 9 to 3½ percent instead of 3, bringing

the level to the highest since 1934, there was the usual explosion by the Patmans and Kerrs in Congress against "tight money." But as the Guaranty Trust Co. of New York pointed out in its July Survey, present rates appear high only in comparison with the abnormally low rates of the depression years and the artificially maintained rates of the war and early postwar periods.

Longer-run comparisons show, in fact, that present interest rates are still quite moderate for a time of active business. Rates on commercial paper, averaging about 4 percent, compare with 6 percent in 1929 and 7½ percent in 1920. Before 1929, a rate below 4 percent was exceptional. As for the preceding 3 percent Federal Reserve discount rate, never until 1930 did any Federal Reserve Bank set a rate below that level.

Nor is the rate structure in the United States high in relation to those elsewhere. Of the 32 foreign central-bank rates listed in the *Federal Reserve Bulletin* for July, only five are below that in the United States. This is in spite of the fact that many countries still maintain unjustifiably low central-bank rates. The maintenance of short-term interest rates at too low a level, in fact, is one of the main explanations of the continuance of inflation in those countries. Excessively low rates always encourage overborrowing, which means an expansion in the supply of money and credit, which in turn causes commodity prices to rise even further.

### IT CAN'T GO ON FOREVER

What the Federal Reserve authorities and the Treasury Department have been doing in the last two and a half years has not been to make money tighter, but simply to allow the money market to tighten itself as the demand for credit increased.

It is possible, of course, for a government or a central bank to keep money rates low for a long time, either by printing money directly or by permitting the overborrowing and consequent expansion of credit to which excessively low money rates inevitably lead. What is less well understood is that cheap money cannot be continued indefinitely. It sets in motion forces that eventually drive interest rates higher than if a cheap-money policy had never been followed.

The expansion of money and credit that is necessary to hold interest rates down also raises commodity prices and wages. Higher commodity prices and wages make it necessary for businessmen to borrow correspondingly more in order to do the same volume of business. Therefore the demand for credit soon increases as fast as the supply. Later on, still another factor comes in. When both borrowers and lenders begin to fear that inflation is going *to continue*, prices and wages begin to go up *more* than the increase in the supply of money

and credit. Borrowers want to borrow still more to take advantage of the expected further rise in prices, and lenders insist on higher interest rates as an insurance premium against expected depreciation in the purchasing power of the money they lend.

### THE BRITISH EXAMPLE

When this happens in an extreme degree, we get a situation like that in Germany in November of 1923, when rates for "call money" went up to 30 percent per *day*. This phenomenon in mild degree is already evident in Britain. The First National City Bank of New York has just pointed out in its August letter, for example, that while the U.S. Treasury 2½s were trading around 86 in June, the British Treasury 2½s issued in 1946, "during the last dying gasp of the cheap-money policy of the United Kingdom," could be bought at 50, or half the original purchase price. Yet corporate shares in Britain have been bid up to levels where returns to the investor are in many cases substantially lower than on gilt-edge bonds. As one London investment house explains the matter, "The argument is, indeed, put forward that, since the pound has been depreciating in the past decade at an average rate of 4¾ percent per annum, any investment likely to show a total net return on income and capital accounts over a given period of less than this amount is giving a negative yield and should be discarded." ❁

## Tragedy of the Franc

August 26, 1957

The new camouflaged devaluation of the French franc is not only one more humiliating economic experience for France itself, it is one more dramatic exposure of the bankruptcy of the whole postwar international currency scheme imposed on the world mainly by the late Lord Keynes and Harry Dexter White. This includes the cavalier rejection of the international gold standard as a "barbarous relic," and the substitution of a built-in system of exchange control with a paper-currency unit pegged by each government at an artificial, arbitrary, and unreal valuation supported by police penalties, import quotas, import licenses, and import taxes, bilateral trade agreements, export subsidies, the International Monetary Fund, the European Payments Union, and similar futile substitutes for sound internal policies.

For a full century before 1914 the French franc, in terms of gold, sold without change at a rate about 145 times as high as it is today. In terms of living costs the situation is as if, in the U.S., a dollar today were to buy

half as much as a cent did in 1914. Yet the tragedy of the French franc does not stand out in the world today as some glaring exception. It is, on the contrary, typical of what has been happening to nearly every currency in the world since the outbreak of the second world war.

### WORLDWIDE INFLATION

In *Newsweek* a few weeks ago (July 1), I printed a table showing the percentage decline in the purchasing power of 56 different currencies between January 1948 and December of last year. The median decline of these 56 currencies in this nine-year period was 33 percent. The French franc, it is true, then showed a fall of 52 percent. But thirteen currencies had fallen more. The currencies of Chile, Paraguay, Bolivia, and Korea declined from 93 to 99 percent; the British pound sterling 34 percent, and the American dollar, the supposed world's currency anchor, 15 percent. Each country has a theory that its own inflation is of some "new type" due to some malicious influence outside of its own control. But in each case the real cause is that the country has printed too much paper money.

When, in September of 1949, some 30 countries, following the example of the British pound sterling, devalued their currencies, reassuring statements were made nearly everywhere that thanks to this great major operation the cancer had been removed; the devalued currencies were now all at "realistic" levels, the balance of trade would once more be restored, and currency units would be permanently stabilized. It was forgotten that if the old practices continued, the process leading to further devaluation would simply start all over again.

### BUREAUCRATIC CHAOS

There is, unfortunately, no reason to suppose that the franc is any more likely to remain stable at its new level than it did at its 1949 level. For though some temporary reforms have been put into effect—an increase in the discount rate, a restriction of credit, a cut in government expenditures, an increase in taxes—France has retained the old system of arbitrary exchange controls, with a mere change and simplification of details. Instead of allowing the franc to be freely bought and sold at whatever prices buyers and sellers can agree upon—which would lead to an automatic restoration of the balance of trade—France continues to fix the franc at an arbitrary "official" level, and to try to balance trade artificially by offering a 20 percent subsidy on most exports and imposing a 20 percent tax on imports (except fuels and raw materials "vital" to French industry). Meanwhile, the French economy remains honeycombed with

protections, subsidies, vast welfare programs, and rent, price, and wage controls.

The Keynes-White International Monetary Fund system, with its national paper moneys traded at government-pegged prices enforced by police power and a crazy quilt of bureaucratic controls, has led only to continuous inflation, trade disruption, and monetary chaos. There is no substitute for sound internal policies in each country. The only real cure for the present world inflation would be a return to the full international gold standard and the disciplines and restraints which maintain that standard. ❁

## Collapse of a System

September 2, 1957

The new devaluation of the French franc (counted by one researcher as its eleventh devaluation in 21 years) is a still further proof, if any were needed, of the weakness, instability, and bankruptcy of the paper-money exchange-control system built in by Lord Keynes and Harry Dexter White after the second world war under an International Monetary Fund. This system is a *tour de force*. It combines the alleged disadvantages of the international gold standard with all the real disadvantages of a floating paper-money standard, with none of the merits of the first and none of the compensations of the second.

A floating paper-money standard (as in Britain between 1931 and 1939) is, of course, inherently unstable, subject to every political pressure and bureaucratic caprice. It tends constantly toward more inflation. It is argued, however, as an “advantage,” that prices and wages in the country with a floating paper money can be kept “independent” of world prices and wages.

A floating paper-money system also has the (comparative) advantage that fluctuations of the currency in terms of other currencies do not too greatly disrupt trade between that nation and others, and do not create a “dollar gap” between its imports and exports. For when a country’s paper currency begins to depreciate, the rise of internal prices and wages is offset in the foreign-exchange market by a corresponding decline in the price of that currency in terms of other currencies. And a floating currency is always fully convertible at the market rate.

### MASKING INFLATION

What happens, instead, under the present system? Within each country there is constant pressure to

maintain “consumer purchasing power,” easy money, ever-rising wages, and “full employment”—in brief, inflation. So each country inflates. But there is an agreement with the International Monetary Fund to maintain the official exchange value of the inflated currency. This is done by forbidding people to buy and sell that currency except at the official rate. This official overvaluation of the currency encourages imports, discourages exports, and creates a “balance of payments” crisis. The inflating country then seeks to offset all this by a maze of import quotas, higher tariffs, export subsidies, and multiple exchange rates. The problem finally becomes insoluble, and then the bureaucrats kick the whole economy downstairs.

The result is a series of violent devaluations, such as the worldwide crisis in September 1949, and the new French crisis today. Devaluation is a drastic remedy, equivalent to cutting off a leg to save a life. Yet as France has illustrated since 1949, the remedy is at best temporary if the patient continues the same practices as in the past. Moreover, each devaluation intensifies fears of further devaluations, of that currency and of others, and so makes the maintenance of the whole system more and more precarious.

### RETURN TO GOLD

The entire IMF system of exchange control of paper moneys at arbitrary rates should long ago have been abandoned. But the only official suggestion that this be done has come from Ludwig Erhard, Economics Minister of Western Germany. Other officials talk privately of another devaluation of the franc and a smaller one for the British pound. A still more astonishing proposal is that the pound sterling be left unchanged in value while the American dollar, German mark, and Swiss franc be “revalued” upward by 10 percent. Such proposals have been aptly described as prescribing surgery on the healthy to cure the sick.

The only real permanent cure is a return to the international gold standard. As Philip Cortney has put it: “It should have become obvious by now that none of the important problems (like the prevention of booms and depressions, the establishment of freely convertible currencies plus stable exchange rate, the expansion of multilateral, unhampered international trade, the union of Europe) can be solved without a return to the international gold standard. . . . The gold standard is the only protection of the politicians against extravagant expenditure requests from pressure groups of all kinds. It is the only safeguard against demagoguery and social disorder.” ❁



## What Makes Reuther Big

September 9, 1957

Walter P. Reuther, head of the United Auto Workers Union, has always been an adroit politician and propagandist, but his latest proposal to the three major motor companies is his masterpiece. It devotes 21 eloquent paragraphs to declaring that inflation is a bad thing and that someone should do something about it. So here's the scheme. Let the automobile companies cut their profits. Let them reduce the prices of 1958 models "to levels averaging at least \$100 below" 1957 models. In return, though his UAW will still presumably demand "the biggest wage increase in the history of the union," he promises to give "full consideration" to the effect of the price reduction on the corporations' earnings "in the drafting of our 1958 demands." Such sacrifice is breath-taking.

It may be, however, that Reuther's proposal will prove a propagandistic boomerang. The heads of the three big automobile companies have all made effective replies. Harlow H. Curtice of General Motors has pointed out that the straight-time hourly wages paid by GM have increased 72 percent since 1947, though the cost of living has gone up only 25 percent. He has also called attention to the "unmistakable similarity" of Reuther's current proposal to the "publicity maneuver" that Reuther used during his union's 119 day strike against GM in 1945-46. Then also he insisted that GM could lower the price of Chevrolets by \$100 and still grant his wage demand. Then also he demanded that the company "open the books" to prove or disprove its "ability to pay." And, as Curtice unkindly points out, Reuther also publicly admitted only a few days after the settlement of that 119-day strike that "the whole question of producing the books was merely a public-relations job on our part" to put the company "over a barrel."

### CUT WAGES FIRST?

L.L. Colbert, president of the Chrysler Corp., correctly characterized Reuther's proposal in his own reply: "While you propose that we absorb all cost pressures already put upon us and ahead of us and, in addition, reduce the price of our 1958 cars, you merely offer to take into 'consideration' the financial effect of the proposed price reduction when you confront the automobile industry with your 1958 demands, which you have described as 'the largest package we've ever demanded.' Would it not be just as logical for the automobile industry to ask the members of the UAW to take an immediate and sizable wage cut, which the companies would then 'take into consideration' in pricing their 1958 automobiles?"

Henry Ford II, finally, for his own company, points out that since 1948 Ford wages have gone up 70 percent while the price of the 1957 Ford, "a far superior product to its 1948 counterpart in every respect," has gone up only 30 percent—"less than half as much." And Ford sums up: "Thus, having poured gasoline on the fires of inflation, you now stand by and tell us how to fight the blaze."

### THE MEAT HE FEEDS ON

It is easy to prove that Reuther's proposal is an empty propaganda gesture, wholly without practical merit. It is perhaps more important to ask how it comes about that a single labor leader has acquired the power which this arrogant proposal reveals. The answer is simple. He has this enormous irresponsible private power because Congress has conferred it on him.

The automobile companies are rightly prohibited from combining to fix their prices against the buying public. They do not dare even to negotiate as a unit with Reuther. But he is aided and abetted by the law to monopolize the labor of the entire industry. He is free to play the automobile companies against each other by pulling a strike in one and not in its competitors. The auto companies, on their side, are *compelled by law* to bargain exclusively with his union, no matter how unreasonable its demands or how insulting its tone. The Norris-LaGuardia Act and the Wagner-Taft-Hartley Act are the meat upon which this our Walter feeds that he is grown so great.

This is the situation to which the Administration and Congress remain persistently and willfully blind. Their impotence is self-imposed. ❁

## Set Currencies Free

September 16, 1957

When the governors of the International Monetary Fund gather in Washington on Sept. 23 for their annual meeting, they may be counted on, if past experience is any guide, to deplore the worldwide inflation that has continued ever since the fund was set up twelve years ago. They will no doubt once again recommend that nations balance their budgets, reduce barriers to international trade, move toward convertibility of their currencies, and refrain from creating multiple exchange rates. Some delegates may even suggest that nations stop printing more paper money.

But after this collective homage to the economic virtues has been duly paid, one delegate after another will explain that his own country continues to face a



special situation and must continue to impose a few restrictions on convertibility, a few barriers to imports or subsidies to exports, till the “emergency” is over.

### EXCHANGE CONTROL

Each year the pretense is kept up that despite “disappointments,” real “progress” has been made toward “convertibility” and “stability.” The blunt truth is that since the International Monetary Fund was established the depreciation and debasement of currencies has gone steadily on from year to year. Worldwide inflation is rampant. And it is governmental policy that permits or creates this inflation. It is the system of the International Monetary Fund itself which encourages, prolongs, and enforces exchange control. This in turn requires for its enforcement a network of internal and external controls, of artificial currency valuations, tariff barriers, import quotas and export subsidies, that regiment national economies, distort prices and production, create so-called “dollar gaps,” and unbalance and disrupt international trade.

The only ultimate cure for this is a return to the international gold standard. But the situation is too chaotic, the network of government controls is too extensive and demoralizing, and confidence has been too profoundly shaken, to permit this to be done overnight. No government knows at what gold value it could safely set and maintain its currency unit to prevent either a dangerous inflation or a dangerous deflation.

There is one indispensable first step. This is to dismantle the entire exchange control system supported by the International Monetary Fund and to let the exchanges go free. This is the step that Ludwig Erhard, West Germany’s Economics Minister, has been almost alone, among high government officials, in recommending. Let us see some of its results:

The so-called problem of convertibility would be solved. Free exchanges would automatically mean free and full interconvertibility of currencies. Tangier, to take an illuminating illustration, is a free money zone. A dispatch from Morocco to *The New York Times* of Aug. 31 declares: “In Tangier anyone can import anything from anywhere. . . . Since any kind of money is exchangeable into any other kind of money in Tangier’s banks at the free market—that is, uncontrolled—rate, there will be no difficulty in paying for hard-money imports.”

For similar reasons, the so-called problem of the “imbalance of foreign trade” would be solved. In the last week of August, French Finance Minister Gaillard released figures showing that, since the partial devaluation of the franc, France’s \$118 million deficit with the European Payments Union had been transferred into

a credit balance of \$36 million. This is merely because the French franc was allowed to sell nearer to its free market value.

### TO RESTORE CONFIDENCE

Free exchange rates, of course, would also solve the so-called “dollar shortage,” which is merely a result of overvalued foreign currencies.

Free exchange rates would not, it is true, solve the problem of inflation or monetary instability. But they would at least reveal such instability from day to day, instead of hiding it, as exchange control does, until the whole false front collapses. When exchange rates were free, they could be stabilized only by policies within each country calculated to restore confidence both of nationals and of foreigners in that country’s currency. Canada has shown the way. Stability begins at home. The only cure for inflation is to stop inflation. ☼

## Creeping Inflationist

September 23, 1957

As nearly everybody professes to be against inflation (even those who fervently advocate the very things that cause it) it is refreshing to encounter a writer like Sumner H. Slichter of Harvard, who frankly wants inflation and doesn’t think we can get along without it.

He is careful, it is true, to say that he is only in favor of “creeping” inflation, not galloping inflation, though he is often vague concerning the exact point where a creep becomes a canter. He has been at times indiscreet enough to suggest that a price rise of 2 or 3 percent a year would be about right. This proposal has been thoroughly discredited. It has been pointed out that even if we could control an inflation to a rate of 2 percent a year it would mean an erosion of the purchasing power of the dollar by about one-half in each generation.

Even so, this would not accomplish Slichter’s announced purpose. He thinks prices must go up this much in order to meet the unions’ annual wage demands. But the moment Slichter’s inflation scheme was openly put into effect, union leaders would simply add 2 percent (or whatever the planned annual inflation was) on top of the demands they would have made anyway. In fact, lenders, investors, manufacturers, retailers, speculators would all mark up their demands or change their operations to beat the inflation, which would thereupon race to a crack-up. A declining currency must eventually obey the law of acceleration that applies to all falling bodies.

### HOW FAST IS A CREEP?

But Slichter is irrepressible. In the September-October *Harvard Business Review* he not only continues to commend a creeping inflation, but reprimands Neil H. Jacoby, a former member of the Council of Economic Advisers, and C. Canby Balderston, vice chairman of the Board of Governors of the Federal Reserve System, for being against inflation. Space does not permit a detailed analysis of all the errors and confusions in Slichter's article, but it may be helpful to cite a few examples.

He declares that it is "incorrect" to believe that "creeping inflation is bound sooner or later to become galloping inflation," because this hasn't happened in the last 25 years in the United States. Well, our cost of living has more than doubled in the last seventeen years. Pretty good for a creep. And Slichter might take a look at the French franc, which is at considerably less than one-hundredth of its 1914 purchasing power. Or at the median loss of one-third of their value by 56 different currencies in the last nine years alone (*Newsweek*, July 1).

Slichter is callous about the losses suffered in recent years by the thrifty. Of the millions of savings-bank depositors and holders of government bonds who have seen the purchasing power of their holdings shrink by a third or a half, he writes coolly: "These people have paid the penalty for poor investment judgment." Their poor judgment consisted, in brief, in trusting their country's money and in answering their government's appeal to buy war bonds. Did Slichter warn against buying war bonds when they were being offered? Is he candid enough to warn everybody that it would be poor judgment to buy future bonds as long as "creeping" inflation continues?

### WHAT A WINS, B LOSES

Slichter's fixed idea is that constant creeping inflation is necessary to maintain full employment. This leads him to misstate an argument of Jacoby's as a "suggestion that prices be kept stable by not permitting unemployment to fall below 4 percent." The truth is that full employment or its absence has no necessary connection whatever with inflation, but depends wholly upon the maintenance of fluid and functional interrelationships between wage rates and prices. Slichter does not understand the argument that unions cannot raise the real wages of the whole body of workers, and his attempted refutation misses the point.

Finally, in his efforts to minimize the harm done by inflation, Slichter fails to see that when employment

is as full as it is today, further inflation must hurt on net balance as many people as it helps, for the gains in dollar income resulting from inflation must be offset by the losses in dollar purchasing power. ☸

## Subsidizing Socialism

September 30, 1957

Just before he retired as director of the International Cooperation Administration on Sept. 12, John B. Hollister issued a farewell directive to the effect that: "The United States is convinced that private ownership and operation of industrial and extractive enterprises contribute more effectively than public ownership and operation to the general improvement of the economy of a country . . . therefore . . . I.C.A. will normally not be prepared to finance publicly owned industrial and extractive enterprises." This directive was promptly repudiated by the State Department, which was reported to be "flabbergasted" and "angered" by it.

The incident throws a brilliant light on the nature of our foreign-aid program. The *New York Times* account declared, for example: "More than half of India's industry is state-owned. Thus, an announcement that the United States intended to follow a harsh line against aid for state-owned industry might logically have been read in New Delhi as a studied public insult. In addition, the department was unhappy about the implication that the United States intended to use its aid program as a form of bribery to stop socialization abroad."

### FOREIGN-AID DILEMMA

These comments reveal quite clearly the dilemma into which the foreign-aid program has landed us. We have been subsidizing, encouraging, and prolonging the continuance of socialism abroad. Therefore, by a strange, inverted logic, to stop subsidizing socialism in foreign countries is to interfere in their internal affairs! Not to subsidize India's grandiose socialistic program by an enormous further "loan" of about \$500 million becomes "a studied public insult." To stop subsidizing socialistic programs abroad becomes "a form of bribery" to get them to adopt free enterprise!

This dilemma could have been foreseen. I discussed it myself in a book *Will Dollars Save the World?* ten years ago: "Intergovernmental loans are on the horns of this dilemma. If on the one hand they are made without conditions, the funds are squandered and dissipated and fail to accomplish their purpose. . . . But if the lending government attempts to impose conditions, its attempt causes immediate resentment. It is called

‘dollar diplomacy’; or ‘American imperialism’; or ‘interfering in the internal affairs’ of the borrowing nation.”

For ten years the champions of our foreign-aid program have not only failed to face this dilemma but have refused even to acknowledge its existence. When forced reluctantly to confess that their program does subsidize socialism, they reply that it would be “intolerant” to refuse aid to a country practicing socialism. This argument tacitly assumes that foreign socialism, like Epicureanism or Mohammedanism, is merely a private philosophy or religion quite irrelevant to the purpose of our aid. But socialism is a set of policies which reduce and distort production, perpetuate dependence, and nullify the very purpose of our aid.

### SUPPORTING DISRUPTION

It is not merely socialism that our foreign-aid program has supported, but disruptive exchange controls, price controls, inflation, import quotas, and export subsidies. In fact, our foreign-aid dispensers once made it a condition of our aid that countries receiving it should discriminate against American goods! (This was called “limiting dollar imports.”)

If the “economic” part of our foreign-aid program were completely abandoned, foreign nations wishing to attract outside capital for development would have to appeal to private investors. This means that they would have to follow policies calculated to assure repayment of the loans made to them. But the free-enterprise policies necessary to create confidence on the part of private foreign investors happen to be precisely the policies that will most rapidly raise the production and living standards of the “underdeveloped” countries and balance their international trade.

The billions our government has given away have not merely failed of both their economic and political purpose, but they have delayed the return to currency convertibility and the restoration of private production incentives that would otherwise have taken place. ❁

## How to Wipe Out Debt

October 7, 1957

When it is pointed out to our Republican Administration, as it was to its Democratic predecessors, that our huge national debt continues to mount, a favorite defense is that it has not risen as a percentage of the national income. This reply ignores the fact that the national income has gone up (in dollar terms) largely because prices have gone up, and that prices have gone up because of the currency debasement brought about

partly by the very deficit financing that increased the debt. What this defense amounts to, in short, is a boast that the burden of the national debt has not increased because it can now be paid off in debased dollars.

### UNAVOWED BANKRUPTCY

There are few governments today that cannot make such a boast. At the bottom of this column I append a table, taken from the August issue of *Pick's World Currency Report*, showing what has happened in the last nine years to the national public debts of a dozen leading countries. Only three of them are smaller in terms of their own currencies; the other nine are all larger in terms of their own currencies. Yet in spite of the fact that they now owe more in nominal currency units than a decade ago, the United States, Brazil, France, Sweden, and the United Kingdom owe much less in real terms than a decade ago. Though the U.S. debt has increased 24 billion in dollars since 1948, the reduced purchasing power of the dollar has wiped out the equivalent of \$42 billion of that debt. Though France increased its debt since 1948 from 3,412 billion to 6,506 billion francs, it also wiped out 3,383 billion francs of the 1948 purchasing power of such a debt.

This is the way governments are today cheating their creditors—precisely the citizens who responded to their patriotic appeals for help.

There is nothing new about this process. It was old when Adam Smith denounced it in *The Wealth of Nations* in 1776: “When national debts have once been accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid. The liberation of the public revenue, if it has ever been brought about at all, has always been brought about by a bankruptcy; sometimes by an avowed one, but always by a real one, though frequently by a pretended payment.

“The raising of the denomination of the coin has been the most usual expedient by which a real public bankruptcy has been disguised under the appearance of a pretended payment. . . . A pretended payment of this kind . . . extends the calamity to a great number of other innocent people. . . . When it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open, and avowed bankruptcy is always the measure which is both least dishonorable to the debtor, and least hurtful to the creditor. The honor of a state is surely very poorly provided for, when, in order to cover the disgrace of a real bankruptcy, it has recourse to a juggling trick of this kind, so easily seen through, and at the same time so extremely pernicious.”



Adam Smith then goes on to show how “almost all states . . . ancient as well as modern” have “played this very juggling trick.” It may be added that, since the substitution of paper for metallic money, the trick has become much easier and therefore more frequent. It may also be added that the debtor class today, including as it does most corporation stockholders, is probably as rich as the creditor class, which includes savings-bank depositors and owners of savings bonds.

## NATIONAL DEBTS

(In billions of currency units)

	Nominal Paper Units 1948	1957	Adjusted to 1948 Purchasing Power 1957
United States \$	252	276	234
Canada \$	15	14	10
Argentina p.	18	95	26
Belgium fr.	245	328	279
Brazil cr.	23	67	20
France fr.	3,412	6,506	3,123
Italy l.	2,315	4,805	3,604
Netherlands fl.	26	18	12
Spain p.	53	90	59
Sweden kr.	11	14	10
Switzerland fr.	11	8	7
United Kingdom £	25	27	18 ⚙

## Paper-Money Blizzard

October 14, 1957

The delegates to the International Monetary Fund, representing more than 60 nations, met, talked, heard speeches, and went home. No fundamental change was recommended. No one asked for a basic reappraisal of the whole tottering exchange-controlled paper-money system symbolized by the fund. The one general point of agreement seemed to be that U.S. taxpayers ought to dump more money in the fund to help bail other nations out.

Just before the fund met, however, the British Government made a courageous decision. It increased the bank rate from 5 percent to 7, putting it on the highest level since 1920. It was the only time in this

century, except at the outbreak of the first and second world wars, that the bank rate had been raised by two percentage points in a single jump. In addition, Peter Thorneycroft, Britain's Chancellor of the Exchequer, announced that the government had asked the banks to hold their loans during the next year to the level of the last year. And he pledged that expenditure by government departments and nationalized industries for building and expansion would be held at the present level for two years more.

### WHY SO DRASTIC?

These measures are drastic. They will force the British Government and British business to pay substantially higher interest rates for new loans. They caused an immediate break in the security markets. And they were supplemented by a hint that the government would accept even unemployment in its determination to stop inflation and defend the pound.

But one question raised by this move seems to have been all but neglected. Why did Britain's action have to be so drastic? The answer is that governments have broken their word so often regarding their currencies in the last quarter century that only the most drastic action will convince either foreigners or their own people that they mean to keep it now. The French franc has been devalued again only within the last few months. More than 50 different currencies have substantially depreciated in the last ten years. In Britain itself, Sir Stafford Cripps, in the months before he announced the devaluation of the pound on Sept. 18, 1949, had publicly denied a dozen times that he would devalue. Later, in defending this record, he declared self-righteously: “Even if we had then had some future intention of altering the rate of exchange . . . no responsible minister could possibly have done otherwise than deny such intention.”

### UNIVERSAL DISEASE

But though the present drastic action by the British Government was necessary in the circumstances, the question may be asked whether it does in fact, even for the next year or two, give the assurance it was intended to give. British opposition leaders have already denounced the action. Another round of wage-increase demands is expected this autumn and winter. All the British Government can do, as long as Britain's labor laws remain what they are, is to plead once more for labor-union “restraint”—a plea that has not proved very effective in the past.

Britain's problem is a universal problem. It is merely a question of degree. When we look at France, India, or most of Latin America, the prospect of checking inflation is even darker. Even West Germany, which



has been accused of making its currency too strong, is now threatened with an upward push on its price-wage structure.

The only place where any country's currency problem can be solved is at home, by its own efforts, through the restoration of sound internal policies. Yet most of the delegates at the International Monetary Fund seemed to think it the fund's duty to pour in more American dollars to subsidize their domestic socialism and inflation indefinitely. No one talked about a restoration of the international gold standard, which is treated as an impossible dream. In his welcoming address to the fund, in fact, President Eisenhower defined inflation as "the tendency to rising prices," without once indicating that rising prices are merely the consequence of mounting snowdrifts of paper money. The IMF has not cured rotting currencies, but it has kept them inconvertible. ❁

## The Economic Consequences of ICBM

October 21, 1957

The Soviet earth satellite is first of all a smashing propaganda victory. This is primarily what it was intended to be. It will have immense political and military repercussions. Its most important implication is that the Russians may really have the intercontinental ballistic missile of which they boasted in August. They may be expected to make full use of this implication in stepped-up efforts to threaten, cow, divide, and conquer the free world.

The one possible advantage of the launching of the satellite, from our point of view, is that it may shake us out of complacency and remind us more urgently that we are in a life-and-death struggle between two ways of life. The great danger is that some of us may react hysterically, draw the wrong conclusions, and take the wrong actions.

One possible error is to overestimate the Soviet achievement. What the Russians seem to have proved is that, in the field of physics and military weapons, they have developed scientists and technicians equal to our own. But the Russians have not yet proved that their physicists and military-weapon technicians are ahead of ours. This may depend on a point of fact that has not yet been established, and on which some American scientists have expressed skepticism that their satellite weighs as much as 184 pounds, as the Russians claim.

### HOW THEY GOT THE JUMP

How the Russians got the jump on us in launching an earth satellite is, in retrospect, clear. We divorced our

earth satellite project from our military ICBM efforts, divided responsibility for it, overlooked its huge propaganda potentialities, talked and boasted freely, and published our planned techniques in detail. The Russians read what we published, but published practically nothing themselves, and secretly drove ahead. The "cooperation" on the "International Geophysical Year" was all one way. In addition, the Soviets have kept us infiltrated with spies.

But perhaps the most important factor is that the Russians acted on the assumption that they were at war with us and we acted on the assumption that we were at peace with them. They hardly needed to send so many spies. Dr. J. Allen Hynek, associate director of the American program set up to trace the course of our own satellite when launched, is authority for the statement that the Russians are watching their own satellite, at 75 stations, through telescopes copied from an American model which he and Dr. Fred L. Whipple gave the Russians in June. But while we thought we were cooperating in a world scientific project, the Russians knew they were competing to be the first to launch an enormously powerful propaganda weapon, as an evidence of their possession of an intercontinental ballistic missile. They took no chances either on coming in second or on public failure. They made no announcement until the satellite had succeeded.

### COMMUNIST PRODUCTION

One false conclusion into which we should not hysterically rush is that the "Socialist society," as the Russians like to call their system, can compete with our free-enterprise system in overall production. I should like to mention here once more the recent study by Prof. G. Warren Nutter (see this column, *Newsweek*, May 27), who concluded: "Soviet industry seems still to be roughly three and a half decades behind us in levels of output and about five and a half decades in levels of per capita output." We know from information from a thousand sources that the masses of the peoples behind the Iron Curtain are still wretchedly housed, clothed, and fed. Only a few weeks ago the Central Committee of the Communist Party and the government of Russia announced that the present five-year plan would be scrapped at the end of next year and would be supplanted by a new seven-year production schedule covering 1959 through 1965. Authorities on the Soviet economy interpret this as a left-handed confession that the five-year plan has been failing.

The most serious false conclusion to which we are in danger of coming is that, because of the Russian achievement, all plans for economy in government must now be thrown to the winds. Certainly our

government-spending program has contained some false economies. But false economies are the inevitable result of false expenditures. True economy is another name for wisdom in spending. We must save on X to have enough to spend on Y. We must divide our expenditures in the most effective way. We allotted, for example, \$110 million to our earth-satellite program. But since the end of the second world war we have spent some \$40 billion to \$60 billion on foreign aid—a ratio of about 500 to 1.

### ECONOMY STILL NEEDED

It may now, indeed, have become pointless to increase our planned expenditures on earth satellites. But if we are really behind Russia, even slightly, in the development of an intercontinental ballistic missile, then we must make this immediately a “crash” program as well as a research program. For the Russian leaders, if they think they have a commanding lead for even a few months, are unlikely to sit idly by and give us time to catch up with them (as we gave them time to catch up on the atomic and nuclear bombs), but will immediately try to wring every possible diplomatic concession or surrender from us or our allies by veiled or open blackmail.

But if the “missile crisis” forces us to spend more in one direction, it can also enable us to save in other directions. If the threat of missile annihilation threatens countries near to Russia, we can obviously provide a far more effective deterrent by speeding our own missile program than by giving these countries more funds to support a few more token ground troops. And we can soon even cut out some present huge “defense” expenditures rapidly being made obsolete through technological advance.

Certainly neither our governmental expenditures nor our total taxes can be increased further without either weakening our economy in inflation or dangerously increasing the deterrents to total national production. Our long-run security depends as much upon the total strength of our economy as upon the development of specific weapons. ❁

## Swindling Admired

October 28, 1957

Free West Germany and Communist East Germany each had a currency called the mark. East Germany had insisted on an official exchange rate of 1 to 1. But in the free market one West mark exchanged for 4½ East marks.

On Oct. 13, without preliminary announcement, Communist East Germany declared all its old currency worthless and called it in. The holders were allowed to turn in 300 old East marks (the purchasing equivalent of about \$16) for new East marks. They were told they would receive credit in newly opened (government) bank accounts for anything they held above that amount—but all funds found to have been made in “speculative” ways would be confiscated. As the Grotewohl regime decides what “speculation” means, it can confiscate anything it wants from anybody it suspects or dislikes.

It is said that the East German Government did this to “halt inflation.” But the value put upon a country’s currency unit depends on the confidence in it. A fast overnight trick like this does not build confidence. East Germans will want to make sure not to get caught holding much currency in the future. They will get rid of it as fast as they can. But this will mean currency depreciation and inflation.

No doubt one purpose of the switch was to force every citizen to account for his holdings and to put a final squeeze on what little private business remained. In this sadistic aim the Communist regime should be successful. It has doubtless also succeeded in fleecing West Berlin banks and exchange offices of the 20 million or so East marks they had on hand. But the exchange value of these was only about \$1 million—less than the U.S. Government spends every ten minutes. This seems a cheap price for a government to throw away what remains of any reputation for good faith. It has swindled most the very people who trusted it most.

Yet the “democratic” nations are in no position to throw stones. The East-mark swindle is more cynical and ruthless, but no different in principle from the New Deal gold-clause repudiation and gold seizure in 1933 and the steady erosion since then of the dollar, the pound sterling, the French franc, and 50 other currencies. What has happened morally even to the West is revealed in one sentence in a dispatch from Berlin: “Even among West Berliners there was grudging admiration for the surprise achieved.”

### A LESSON FOR THE EDUCATORS

Some of the American responses to Sputnik have not been edifying. Several politicians now hysterically demand more spending on everything. Others are using the earth satellite as an argument for more appropriations for their own pet projects, no matter how dubiously relevant. Thus at the closing session of the

American Council on Education in Washington the speakers declared that the Soviet satellite had shattered the nation's "smug complacency" about its schools and colleges, and it was no longer possible to maintain a topnotch school system on a "starved" budget.

The United States is already spending far more on education than any other nation on the face of the globe. It is a little hard to see how the earth satellite calls for still more courses in sociology, medieval history, business English, French, or folk dancing, however worthy such subjects may otherwise be. It is true, of course, that because of the kind of competition in weapons of wholesale destruction that Russian Communist fanaticism has forced on us, it may be advisable for the Federal government to grant scholarships to a certain number of exceptionally brilliant students, chosen by competitive examination, in, say, physics, chemistry, mathematics, and engineering. The whole of these scholarship funds might be charged against the defense budget.

Perhaps even more important, physics and mathematics might be made part of the required high-school curriculum, in place of some of the easy and trivial "elective" subjects that have been displacing them in the last half century. But this local reform would not require any added governmental appropriations, and so presumably does not interest the educationist pressure group. ☼

## The Cost-Price Squeeze

November 4, 1957

The dispute still boils concerning who or what caused the present inflation. "Labor" and "management" are now blaming each other. Insofar as this dispute is relevant, management has considerably the better of the argument.

The attack on management has been carried on by Walter Reuther on his own, and by other labor spokesmen in the Kefauver hearings. Reuther contends that "exorbitant" profits, not wages, have been the villain promoting inflation. Otis Brubaker, research director of the steelworkers' union, declares: "Wage increases have not caused a single price increase in twenty years."

In its October letter, the First National City Bank of New York points out in reply: "Regardless of what year is taken as a base [from 1939 on] wages and total employment costs in the steel industry have far outstripped gains in productivity. Measuring from 1940, the gain in productivity of 56 percent, while substantial, fell far short of increases in hourly earnings and total

employment costs amounting to more than 200 percent. The result . . . was an approximate doubling of unit labor costs with inevitable pressure for higher prices."

### PROFIT-MARGIN FALL

A much wider study of the same problem was published by the National Association of Manufacturers in September. It finds that the history of manufacturing since the end of the second world war has been one of rising costs per unit of output—particularly labor costs and taxes. Compensation of employees rose 23 percent per unit of output between 1948 and 1956. Corporate taxes rose 32 percent on the same basis. But prices of manufactured goods rose only 10 percent. The result has been a reduction of 25 percent in profit per unit of output between 1948 and 1956.

The decline in the profit margin of manufacturing industries is particularly striking when it is expressed as a percentage of sales. It dropped from 4.9 percent in 1948 to 3.1 percent in 1956. (By way of comparison, the figure for 1929 was 6.4 percent; for 1937, 4.7 percent; for 1940, 5.5 percent.) Thus, concludes the NAM study, "between 1948 and 1956 profit margins as a percent of sales have fallen from a level characteristic of prosperity years to a level characteristic of recession years." Higher costs cannot automatically be recouped by higher market prices.

### WAGES AND OUTPUT

These statistical comparisons by the National City Bank and the NAM prove that the current inflation is at least not the result of the "greed" of manufacturers for exorbitant profits, as Reuther contends. But they do not prove that "the conclusion is inescapable, " as the NAM study puts it "that the current inflationary push is due to the rising costs of labor and the continuing heavy tax burden."

The rise in wages, it is true, as both studies point out, has exceeded the rise in "productivity." But the studies compare *money* wages to *physical* output. In any inflation, no matter how caused, money wages are practically certain to rise more than physical productivity. This is simply because both wages and prices rise in every inflation. It does not necessarily follow that the rise in prices has been *caused* by the rise in wages. Both may have risen from a common cause.

That common cause is not hard to find. Neither the wage rise nor the price rise since 1939 or 1948 would have been possible if it had not been fed by an increased money supply. The money-and-credit supply increased from \$64.7 billion at the end of 1939, to \$172.7 billion at the end of 1948, to \$226.4 billion at the end of 1956.



There would have been no inflation, in short, in the last eight or eighteen years without the cooperation and connivance of the monetary authorities.

This does not mean, of course, that union pressure has had no responsibility for the result. Under present labor laws the government has not merely encouraged but in effect forced the creation of industrywide unions with power to impose continuous wage increases. Unless these excessive union powers are reduced they must either lead to unemployment by forcing costs above prices, or create political pressure for still more monetary inflation. ❁

## Party of Inflation?

November 11, 1957

Inflation has not been stopped by the Eisenhower regime. But it would be worse if the Democrats returned to power. This is the conclusion one is forced to draw from the economic statement issued Oct. 20 by the Democratic Advisory Council.

"This is the worst peacetime inflation in our history," it tells us. The authors of that apparently don't think the American public can either count or remember. In the nearly five years under Eisenhower, wholesale prices have risen about 5.4 percent, and consumer prices, 6.7 percent. Under the Democrats, in the three years from the end of 1945 to the end of 1948, wholesale prices rose 51.7 percent. In the seven years from the end of 1945 till the end of 1952 wholesale prices rose 62.2 percent and consumer prices 47.6 percent.

In those seven Democratic years total bank deposits and currency increased from \$151 billion to \$195 billion, or more than 29 percent. From the end of 1952 until now, under Eisenhower, they increased to \$220 billion, or about 13 percent. The Republican inflation is "worse" than the Democratic only because it comes on top of it. But the *annual* rate of inflation has been lower.

The Democratic statement goes on to denounce the Republican Administration's "characteristically negative" policy of "raising interest and tightening the money supply." The truth is that the Republicans have *expanded* the money supply, which is now at record levels. What these Democrats must want is a still faster expansion—in brief, more inflation.

### HOW TIGHT IS MONEY?

As for our so-called "tight money" policy, whereas the discount rate is now 3½ percent in the U.S., it has been within the last couple of months 4.28 in Canada, 4.5 in

Germany, 5 percent in France, Holland, and Sweden, and 7 percent in Great Britain. Are all these central banks "negative" and sadistic, and bent on creating a depression in their own countries? Or are they, perhaps, at last trying to curb inflation?

The DAC statement charges that "tight money" is ineffective, and that it is too effective. "By the ordinary tests of results," it says, "this policy has failed." Well, prices have continued to rise. But so has the volume of money and credit. By the ordinary tests of logic, this should simply mean that interest rates were not raised *enough* to discourage inflationary borrowing. Yet the DAC statement is afraid that raising interest rates "may stabilize living costs by causing unemployment and economic recession."

The attack of the DAC on Republican inflation is a self-contradiction and a fraud. It pretends to deplore inflation while denouncing the only policies that can stop it and recommending the very policies that create it. The DAC wants cheap money and more credit expansion, which is the essence of inflation. It is "committed unequivocally to the principle of a vigorously expanding economy"—i.e., to a policy of perpetual boom.

### BACK TO PRICE-FIXING

Though the DAC statement expresses fear of "unemployment" even with rising prices, it nowhere admits that this could happen only under one condition—that wage rates rose faster than prices and squeezed out profit margins. But even the possibility of excessive wage rates is never mentioned, let alone any proposal to do anything about them. When it comes to prices, however, the DAC wants to get tough. "We must have an active, firm, and broadly based policy to insure price stability. . . . Those who do not respond to leadership in the public interest must understand that this is the course which leads inevitably to controls." Here then, thinly veiled, is the Democrats' program: Cheapen money, expand credit, increase inflation, and then "fight" it by discriminatory and totalitarian price controls. This is "repressed inflation," a policy whose results are typified in present-day France.

It is true that the Democratic Advisory Council is made up mainly of political has-beens and assorted left-wingers; but it has the blessing of the Democratic national chairman. Until this statement is explicitly repudiated by the majority of Democrats in Congress, therefore, it makes the Democratic Party officially the party of inflation. ❁



## Message of the Sputniks

November 18, 1957

The immediate service of the Russian satellites has been to shake us out of complacency. Their immediate danger is that they may drive some of us into hysterical demands and panicky action. This danger is already evident in the widespread outcry that it is "economy" that betrayed us, and that our salvation lies in spending more in all directions.

So far as long-range missiles and new fuels are concerned, it is obvious that we should spend all we usefully can as fast as we can usefully spend it. But there is a limit to what we can accomplish now merely by spending. We have lost priceless time. And that time has not been lost only by the Eisenhower Administration.

When the Russians captured Peenemünde, the East German rocket-manufacturing center, in the second world war, they stripped it, took over every German scientist and technician that they could, and secretly ordered them to keep developing the rockets and extending their range. The fatal atomic and nuclear warheads, they stole from us. We, on our side, assumed that Russia was our great ally, sincerely seeking "peaceful coexistence," and that whatever problems couldn't be solved through the United Nations and foreign giveaways could be easily handled by "top level" conferences and agreements on a basis of mutual trust. On these assumptions we cut our defense expenditures from a level of \$90 billion in the fiscal year 1945 to only \$12 billion in 1948. Not until after the Korean war partially woke us up did we take an interest again in missiles—after we had given the Russians a six or seven years' start. It is this appalling time handicap that we must now try to make up.

### SQUANDERING NO CURE

It does not follow, unfortunately, that our progress will now be proportionate to our rate of spending, or limited only by what we spend. We cannot atone overnight for all our diplomatic and military mistakes of the last twelve years. Past false economies cannot be rectified by future squandering. Because we saved on the wrong things, it does not follow that it is wrong to save at all.

This is the point that seems to be missed by those who are now so loudly shouting for a great increase in overall spending. Suppose we have to spend now a few billions more a year in missile development? Does it follow that we must increase our total Federal budget by this sum? Or could we not take the amount out of other expenditures? Our nondefense spending alone now comes to something like \$28 billion a year. Among

items out of which a good deal of fat might be cut are some \$4 billion for foreign aid, some \$5 billion for veterans' benefits, some \$3.3 billion for "labor and welfare," and some \$5 billion for agriculture, mainly for price supports and subsidies for not producing.

### SUBSIDIES AS USUAL

The political apostles of spending ought to know that they cannot get a quart out of a pint jug. They ought to know that out of a given volume of resources we can spend more in one direction only by saving more in another. But none of them have had the courage to suggest that the increased amounts they insist should be spent on defense should be taken from any of the welfare or subsidy programs with powerful pressure groups behind them. They want increased spending on missiles but spending-as-usual on everything else. It is only the taxpayers who earn the funds, not the groups they are compelled to subsidize, who are being asked to make sacrifices.

And if the apostles of increased spending do not talk about cutting nondefense expenditures, they are even more silent on the possibility of cutting expenditures on many of the "defense" items that are being rendered superfluous or obsolete by the revolutionary advances in missile warfare. As President Eisenhower rightly insisted in his television talk, "we cannot afford waste." We will need better "*selectivity* in national expenditures of all kinds."

In spite of the increased amounts that may be necessary for missile development it is still possible to cut the total Federal budget. It is still possible to remove from the present tax structure inequities and deterrents to investment and production, and so to increase our national strength. ❁

## Wake Up the Educators

November 25, 1957

EDUCATORS URGE WAKENED NATION. So ran a prominent newspaper headline not many days ago. Yet the facts indicate that it is not so much the public that needs to be awakened as the educators themselves.

This is brilliantly clear from the 226-page report just published by the U.S. Office of Education comparing education in the Soviet Union and in the United States. This study, as summarized by President Eisenhower, shows that "when a Russian graduates from high school he has had five years of physics, four years of chemistry, one year of astronomy, five years of biology, ten years of mathematics and trigonometry, and five years

of a foreign language.” In the United States, fewer than one-third of high-school graduates have taken a year in chemistry; only one-fourth have studied physics; only one-seventh have taken advanced mathematics. And we are far behind even in teaching foreign languages. Russian students learn more of all these academic subjects in ten years than ours do in twelve.

**BEHIND EUROPE TOO**

It is true that the Russian studies are primarily selected to make Russia powerful in war; that Russian schools are instruments of Communist indoctrination. Yet American education in mathematics and the sciences is backward not only as compared with Soviet Russia but with our principal European allies. A dispatch from Germany to *The New York Times* of Nov. 10 found that “The scientific preparation of West German high-school students for admission to universities and engineering colleges surpasses anything that is offered in the United States public-school system as a whole”; while “high schools in France, Britain, Italy, Switzerland, the Netherlands, Belgium, and the Scandinavian countries also give their high-school students a superior education in the sciences.”

What the Office of Education’s latest study also fails to emphasize is that the present American situation in scientific and mathematical education is an appalling deterioration even from half a century ago. In a biennial survey by the Office of Education itself, in 1951, a table was published comparing “percentages of pupils enrolled in certain subjects in the last four years of public secondary day school [high schools].” Here are some of the comparisons it showed:

Subject	1900	1949
Physiology	27.4%	1.0%
Earth science	29.8%	0.4%
Chemistry	7.7%	7.6%
Physics	19.0%	5.4%
Algebra	56.3%	26.8%
Geometry	27.4%	12.8%

**MEETING ‘LIFE-NEEDS’?**

“Enrollments in both mathematics and foreign languages in the last four years of high school,” the study stated, “were smaller percentages of the total pupil bodies in 1949 than in 1934. . . . Percentage enrollments in algebra, geometry, physics, and Latin have shown progressive decreases in all investigations since 1915.”

Yet the Office of Education *approved* this trend. “For the most part,” said its summary, “the changes are

in the direction of more functional education. They represent efforts to meet life-needs of increasingly diverse bodies of pupils.” Commenting on this, in his book *The Restoration of Learning* (1955), Arthur Bestor wrote: “It is a curiously ostrich-like way of meeting ‘life-needs’ to de-emphasize foreign languages during a period of world war and postwar global tension, and to de-emphasize mathematics and physics at precisely the time when the nation’s security has come to depend on Einstein’s equation  $E=mc^2$ .”

Just as some of our military administrators are now blaming our backwardness in missiles chiefly on “inadequate funds,” so most of our educators are blaming their own failures on inadequate funds and calling for huge Federal subsidies. It is our educational system itself, however, and the flabby educational philosophy dominant for the last quarter of a century, that is first of all in need of reappraisal and reform. It is the dominant educationists who have been the real anti-intellectuals, fearful of everything that is difficult and disciplined, including the very knowledge most essential to survival in the modern world. ❁

**A Shot in the Arm**

December 2, 1957

The sudden reduction of Federal Reserve discount rates from 3½ to 3 percent was tantamount to a proclamation that the policy of monetary restraint is at least temporarily abandoned. The action was a victory for the forces attacking “tight money” and pressing for resumption of inflation. It raises once more some fundamental questions about monetary policy.

It is now generally recognized, even by the Federal Reserve authorities themselves, that the reduction of the discount rate from 2 percent in 1953 to 1½ percent in mid-April 1954 was a mistake. It led to a sharp upward spurt in bank loans, and hence to an inflationary expansion of the money supply. It had to be reversed a year later, by the first of seven successive increases—some of which would not have been necessary except for the unwise reduction.

It was once considered the orthodox rule of sound central banking that the rediscount rate should be kept above the rate to prime borrowing customers of the great city banks. This was on the theory that if a member bank overextended itself and had to borrow from the Fed, it should pay a penalty rate rather than make a profit on the transaction. Until recently the Federal Reserve authorities did make it a policy to keep the discount rate at least above the rate on three-month

Treasury bills. But Treasury bills were still selling at an average yield of 3.47 percent in mid-November. This did not justify a cut in the discount rate below  $3\frac{1}{2}$  percent.

### DISCOUNT RATE RULES

A year ago the Bank of Canada announced that until further notice it would adjust its discount rate weekly to maintain it at  $\frac{1}{4}$  of 1 percent above the latest rate on treasury bills. If our Federal Reserve authorities adopted this rule, they would at least make it clear that they were merely following the market and not making money tight out of pure cussedness.

It is often argued that under the American system the discount rate has a merely token importance as compared with open-market operations. This is largely true. This year, for example, member banks have been borrowing an average of less than \$1 billion from the Fed as compared with their total reserves of about \$19 billion and their total loans and investments of about \$139 billion. Yet a sound discount rate should at least be consistent with open-market policy and reflect market interest-rate realities. To cut the discount rate mainly for the “psychological” effect, to give the economy a shot in the arm, is to set a dubious precedent. Was this the most appropriate time—just after the consumer price index had risen for thirteen consecutive months to a new high record—to send up a new inflationary signal?

### WHAT MONETARY POLICY?

The new discount-rate reduction raises once more the whole question of just what should be the objectives of Federal Reserve monetary policy. Under a gold standard the primary objective was clear: It was to protect the integrity of the currency by maintaining gold convertibility at all times. Under a paper standard and a Keynesian ideology the objectives become confused. The Employment Act of 1946 declares that “it is the continuing policy and responsibility of the Federal government to use all practicable means . . . to promote maximum employment, production, and purchasing power.” Many interpret this as a standing order for inflation. Chairman Martin of the Federal Reserve Board has suggested that Congress should declare “resolutely—so that all the world will know—that stabilization of the cost of living is a primary aim of Federal economic policy.

A much better solution would simply be repeal of the Employment Act of 1946. But if that mischievous law is kept, it should at least be amended to add the requirement of price stability as an offset to the heavy inflationary bias in the law as it now stands. This is the

kind of problem we create when we abandon the gold standard.

Regardless of the monetary objectives ultimately adopted, it remains to be seen whether the reduction in the discount rate will achieve its major objectives. If the unions persist in pushing up wage rates, the cut will lead to more inflation without necessarily leading to more employment. ❁

## Our Moral Disarmament

December 9, 1957

The main technical reason why the Russians are presumably ahead of us in long-range ballistic missiles, as Wernher von Braun has pointed out, is that “the United States had no ballistic-missile program worth mentioning between 1945 and 1951,” when the Russians secretly drove ahead.

But perhaps this technical lapse is symptomatic of a deeper weakness. The Oct. 26 issue of *The New Yorker* contained an article by Eugene Kinkead about the Army’s research into the factors which led (in the words of Assistant Secretary Hugh Milton of the Army’s Manpower and Reserve Forces) to “American troops turning renegade in such large numbers and apparently so casually” to Communist indoctrination. One out of every three American prisoners, according to the Army’s study, was guilty of some sort of collaboration with the enemy, and one out of every seven was guilty of “serious” collaboration. Practically none of this is attributed by Army doctors or psychiatrists to physical torture or to “brainwashing” in the commonly accepted sense, but to indoctrination which took the form of a blend of leniency and pressure by their Communist captors.

### ANTICAPITALISM

The reasons for the ease with which so many of our prisoners went over to the enemy were complex. But surely one of them was that they had already been conditioned to an anti-capitalist ideology. In answers to American Army questioners, they frequently used the word Socialism (as Communist propaganda does) rather than Communism. They would say that “while Socialism might not work in the United States, where the people are for the most part well off to begin with, it was a good thing for China and other less advanced nations.” It did not occur to them that this country was not pretty well off “to begin with,” but got that way precisely because it followed the principles of free enterprise.



We face in the world today a supreme irony. Millions of people are fanatically devoted to the slave system called Communism and are willing to die for it. Yet few of us are zealously devoted to its opposite, the system of capitalism, or willing to die for it by that name. True, the name itself is a smear word invented by Marx and Engels in order to imply that economic freedom and private property constitute a system run by and for the capitalists. But few of us are willing to make sacrifices to preserve this system even when it bears a truer name, such as free enterprise. Many of us do profess to be devoted to “democracy,” but fail to understand that democracy with individual freedom is impossible except on a basis of private property and freedom of enterprise.

### SICKNESS OF THE WEST

This paradox is discussed in the course of a brilliant new philosophical work by Ludwig von Mises, *Theory and History* (Yale University Press, \$6). Mises points out that the slavery and debasement under Russian Communism, or any system of complete Socialism, are not accidental: “If an omnipotent authority has the power to assign to every individual the tasks he has to perform, nothing that can be called freedom and autonomy is left to him. He has only the choice between strict obedience and death by starvation.”

Yet leading writers and scientists of the West are contemptuous of economic freedom, the basis of all freedom, and speak with admiration of a system that eclipses all tyrannies of the past in pitiless persecution of dissenters: “It did not occur to the liberal philosophers of the eighteenth and early nineteenth centuries that a new ideology would arise which would resolutely reject all the principles of liberty and individualism and would proclaim the total subjection of the individual to the tutelage of a paternal authority as . . . the most noble end of history.”

This is the weakness and sickness of the West, which is abandoning, in favor of statism and Socialism, the very free-market capitalism which has brought it not only individual liberty but the unparalleled material progress of the last 200 years. “True,” grimly concludes Mises, “Western civilization is decadent. But its decadence consists precisely in the endorsement of the anticapitalistic creed.” ❀

## To Remove Uncertainty

December 16, 1957

It may not seem important to many that the stock market drops violently whenever anything serious happens

to the President’s health. But the stock market is our great business barometer. Its fall reflects the uncertainty that develops through the whole economy. And this, in turn, reflects wider uncertainty regarding our national ability to take instant and proper action in response to any internal or external threat. It is not doubt concerning the policies of the President’s successor that creates most anxiety, but the fear of governmental paralysis in a crisis.

Yet this uncertainty is entirely needless and easily removable. Let us look once more at the constitutional provisions regarding Presidential resignation and disability. Article II, Section 1 reads: “In case of the removal of the President from office, or of his death, resignation, or *inability* to discharge the powers and duties of the said office, the same shall devolve on the Vice President, and the Congress *may by law* provide for the case of removal, death, resignation, or *inability*, both of the President and Vice President, declaring what officer shall then act as President, and such officer shall act accordingly, *until the disability be removed*, or a President shall be elected.” (My italics.)

### CONGRESS HAS POWER

This provision is said to be vague concerning what or who determines Presidential “inability” if a President himself is unwilling or unable to do so. But it explicitly gives Congress power to decide all such details by legislation. If Congress, under this provision, explicitly authorized the President to transfer the powers and duties of his office temporarily, it is inconceivable that the Supreme Court would hold that Congress had acted beyond its constitutional powers.

The President’s right to resign at any time is constitutionally beyond doubt. Even here, however, clarifying legislation is desirable. If a President’s health is such as to force him to consider the grave step of resignation, he should not be confronted with the additional problem of financial sacrifice. Congress should provide that in the event of such forced resignation his salary would continue until the end of his term. Appropriate legislative provision also needs to be made concerning the salaries and expenses of both the President and Vice President during any period in which the latter temporarily assumed the powers and duties of the former.

### TO DECIDE ‘DISABILITY’

Nor is this all that Congress should and could do by simple legislation. It has the clear power, under the constitutional provision just quoted, to say who should pass upon a President’s disability in the event that he himself is unable to do so. And clearly the only body that should be entrusted with the power of relieving



the President of the duties of his office, even temporarily, is Congress itself. Congress, in fact, already has this constitutional power under the impeachment provision. Disability legislation could follow this precedent by providing for a President's removal for disability by a majority vote in the House confirmed by a two-thirds vote in the Senate.

It is reassuring that the Eisenhower Administration itself is now pressing for speedy Congressional settlement of the problem. This matter is so urgent, in view of the repeated crises in President Eisenhower's health and of the present perilous international situation, that it would justify calling a special session of Congress immediately if we were not so near to the regular session. Even now, important time could be saved if the appropriate Congressional committees could immediately frame enabling and clarifying legislation to be submitted to the full Congress as the first order of business.

As Arthur Krock has put it: "There is no real substitute in the American governing system for constant hour-by-hour Presidential leadership." The first need is to enable a President to turn over the powers and duties of his office at least temporarily to the Vice President, and to enable him to do so with clear legal authority and an untroubled mind.

There are wider problems concerning the Presidential succession that might require constitutional amendment. But they can wait. ❁

## Salvation by Spending?

December 23, 1957

It will be some time before we feel the full impact of the blow to American prestige caused first by the sensational launching of the two Russian satellites and then by our own dismal failure at Cape Canaveral. Had any of the excuses so freely offered after the failure been put forward as clear warnings even 24 hours before it, they might have had the desired effect. As it was, the elaborate advance build-up caused the fiasco to do us the maximum harm. It was not reassuring to be told after the event that failure might have been expected because "this was our first attempt." This merely underlines our irretrievable loss of six years when the Russians were laying the groundwork for their missile program between 1945 and 1951. That loss cannot be made up overnight. Our very excuses concede that the Russians are far ahead of us in satellite development—and, presumably, in long-range ballistic missiles.

What is disturbing is not merely our present humiliation but the wrong lessons being widely drawn. Most

of the Democrats in Congress now blame our present predicament on the alleged "economy-mindedness" of the Eisenhower Administration. This is a strange accusation to bring against an Administration that presented a year ago the record-breaking peacetime spending budget of \$72 billion. We are in our present plight not because of "economy," but because of fantastic mis-spending. On our entire earth-satellite program we have spent only \$110 million out of a total 1958 budget nearly 700 times as great.

### WHERE WE CAN CUT

The present pious professions of inability to cut the overall budget ignore the flagrant facts. It has been repeatedly pointed out that our non-defense spending alone now comes to something like \$28 billion a year. This includes \$5 billion for thoroughly mischievous agricultural price supports and subsidies for not producing. It includes grossly swollen items like \$4 billion for foreign aid, \$5 billion for veterans' benefits, and some \$3.3 billion for "labor and welfare." Yet with all the talk in Washington of the nation's peril, nobody dares suggest slashing these items. It is only the taxpayers, those who earn the money from which these handouts are taken, who are being told they must make further sacrifices.

And what of so-called "defense" spending itself? One hears not a word now of the huge wastes in overbuilding, overbuying, and overstaffing pointed out by the Hoover commission. (In 1954 the Army had a ten years' supply of women's uniforms. The Navy had enough canned hamburger to last for 60 years, though it barely keeps for two.) We are still busily turning out obsolescent weapons. The most careful study needs to be given to the persuasive proposals of J. Sterling Livingston in the *Harvard Business Review* that (1) technical problems of future weapons development should be taken out of military hands and put in a civilian agency and (2) private firms should be given greater profit incentives and more freedom to pursue their own research and development.

### FUTILE FOREIGN AID

The most irrational response to the Russian sputniks and our own failure is the proposal to increase still further the huge sums we are giving away to foreign countries. We have already granted them some \$60 billion since the end of the second world war. This did not in the least deter the press of these countries from taunting and jeering us when our Vanguard fizzled. Suppose we had given them not a cent, and instead of dissipating our strength had used a fraction of that sum to keep unchallengeably ahead of Russia in military weapons and research? We would have helped those nations, as

well as ourselves, far more than we actually have. It is futile to try to buy a nation's good will when one has lost its respect.

The proposals in Washington to meet the new Russian threat by increasing foreign handouts, spending more in all directions, and resuming debasement of the currency by inflating still further, suggest a panicky motorist who, when he suspects he is on the wrong road, refuses to stop and take his bearings, but frantically increases his speed in the same direction that he has been going. ❁

## Too Much Labor Law

December 30, 1957

The subway strike in New York occurred because the motormen resented being forced into an all-inclusive union where they could not "bargain collectively through representatives of their own choosing."

The phrase in quotation marks is one of the declared aims of the Taft-Hartley Act. In New York, the subway bargaining unit is determined by the Transit Authority. But the strike illustrated one of the notorious ways in which the Taft-Hartley Act fails to live up to its own professions. Under that law the National Labor Relations Board determines the "appropriate bargaining unit." Whatever union gets the majority vote in such a unit thereupon becomes legally the exclusive bargaining agent for everyone, including those who voted against it. By the NLRB's power to decide the bargaining unit, plus the monopolistic bargaining power then given to the winning union, the right of the individual worker to be represented by an agent of his own choosing is in effect denied.

### MORE INTERVENTIONS

To all those who hope for any balance or sanity in our labor laws, Secretary Mitchell's speech before the AFL-CIO convention on Dec. 5 was disheartening. The Labor Secretary recommends changes that need not or ought not to be made. He opposes nearly every change that ought to be made. He wants to increase still further the multitude of Federal interventions that have had such baneful results since they began a generation ago. He opposes the repeal of those that have done the most harm. He recommends all sorts of detailed regulation of union pension and welfare funds—and then admits, at the end, that "there are laws already on the books, after all, against bribery, against fraud, against murder and embezzlement." But he is adamant against repeal of pernicious provisions.

Mitchell pays pious lip service to three "general principles." Present labor law, and his own recommendations, violate all three.

His first announced principle is "to protect by law the right of American working men and women to organize into unions and to bargain collectively through representatives of their own choosing." The Taft-Hartley Act, as we have seen, thwarts this second right. And the right of the individual worker not to join a union is denied by the Secretary.

His second announced principle is that labor and management "each be free from governmental domination." But through our network of Federal labor laws both the individual worker and the individual employer are dominated by government. The freedom of the individual worker to get and keep a job without joining a union is denied. The freedom of the employer to seek employees of his own choice, or to replace them, is greatly abridged.

### NO RIGHT-TO-WORK LAW

Mitchell's third principle is "to protect the basic rights of individuals." But our Federal laws and regulations abridge the basic rights of the individual in favor of the coercive privileges of the group.

Specifically, the Labor Secretary declares, the Administration "will not recommend a so-called national right-to-work law and we will oppose such legislation if it is proposed."

This brings us close to the heart of the issue. The Taft-Hartley Act contains a self-contradiction. Sec. 8a declares: "It shall be an unfair labor practice for an employer . . . by any term or condition of employment to encourage or discourage membership in any labor organization." But the "encourage" is canceled by a provision validating the compulsory all-union shop. Mitchell still wants to impose compulsory union membership.

The Taft-Hartley Act should either be amended by a consistent Sec. 8a, which would outlaw the compulsory union shop as well as the compulsory non-union shop (prohibiting an employer or a union from making any hiring stipulation either way), or, if the unions refuse to accept such a two-sided enactment, the Taft-Hartley Act should be repealed. We need not start passing "anti-labor" laws, but we might try repealing a few anti-management laws. Perhaps the best course, in fact, would be the repeal of all labor legislation except that forbidding force, fraud, coercion, or intimidation by anyone. ❁



1958





## To Control Spending

January 6, 1958

With the present missile scare and deflation scare, the outlook for government economy is even dimmer than it was a year ago. The main hope of those who would like to see the Federal budget under some sort of responsible control lies in reforming the budget-making process itself. An opportunity exists in the very fact that Congress will probably be asked to raise the debt ceiling again. If Congress feels forced to do this, it can and should exact a price.

The minimum price should be a reform urged by the Hoover commission—that Federal expenditures be placed on an “annual accrued basis.” This technical term means simply that Congress should provide funds only for work done or services and goods actually received by the government in the fiscal year. Only by this reform can Congress regain the “power of the purse”—the control over annual spending—that it has lost.

Our Federal fiscal practices have become so complicated and involved that few laymen—and, in fact, few congressmen—understand them. It is still not clearly and generally understood that the Federal government has *two* budgets—the obligation budget and the expenditures estimates. Congress has control today only over the money it appropriates in any year; it does not have control over how much money is actually spent each year. Its present practice is to appropriate the entire sum necessary to complete a given Federal project regardless of how many years that project actually will take. This practice has resulted in some huge annual “carry-overs” of unexpended Federal funds. These now are in the neighborhood of \$70 billion.

### HOW CONTROL IS LOST

The results of this practice were brought out graphically by Sen. Harry F. Byrd in a statement on Oct. 2 last: “On the last day of the session I estimated that the President’s January appropriation requests had been reduced by \$6 billion or more, and I called upon the President to reduce expenditures by the same amount. The President’s mid-year review clearly indicates that these reductions in appropriations will result in virtually no reductions in Federal expenditures this year. Obviously the President will use unexpended balances in previous appropriations to keep expenditures at the level he estimated last January, or higher. This is contrary to the intent of Congress, which expected a substantial part of the reductions in appropriations to be reflected in this year’s expenditures.” The situation, the senator concluded, “clearly shows that Congress has lost

control over Federal expenditures and makes it imperative that this control be recaptured.”

### ANNUAL REVIEW

In a twelve-page pamphlet just published by the Citizens Committee for the Hoover Report, the case for “annual accrued expenditure budgeting” (or “pay-as-you-get”) is very clearly and ably presented, and objections systematically answered. I should like to deal here with one argument not covered by the committee’s report because it seems to me typical of the kind of objection now most likely to be heard. It was voiced by Hanson W. Baldwin in *The New York Times* of Aug. 22: “The Defense Department does not exist to show a profit-and-loss statement or to keep nicely balanced books. It exists for one purpose only—national security and combat effectiveness. If we emphasize the business ideal of cost accounting at the expense of combat effectiveness, we are lost.” This is clearly a false antithesis. Proper accounting practices are designed precisely to *increase* effectiveness and *to detect and prevent misspending* of limited resources. Wholly apart from the undemocratic nature of such a system, it would not increase combat effectiveness to deprive Congress of the right of annual review and control of expenditures.

H.R. 8002, the House bill which provides for placing Federal expenditures on an “annual accrued basis,” has twice passed the Senate unanimously in an even stronger version. It has been endorsed by the President, by former Secretary Humphrey, by the Director of the Budget, and unanimously endorsed by the House Committee on Government Operations. It should be budget reform No. 1. ❁

## Convert the Communists

January 13, 1958

In this new year we face what may be the gravest crisis in our history. The very survival of the United States as a free nation, the survival of civilization, may be at stake.

Our predicament is, at least in part, the result of our own slack policies. We allowed our atomic and nuclear secrets to be quickly and easily stolen. We neglected for six irretrievable years the development of long-range ballistic missiles. So we have helped to bring about the alarming rise in neutralism and appeasement sentiment among other NATO members—which has led them, in turn, to put pressure on us not to strengthen the alliance, but to seek negotiations with the Kremlin.

Yet probably the worst thing that could happen to the West would be to *get* a disarmament agreement with Russia. Any sense of security it gave would be illusory. It would bind us, but it would not bind the leaders of the Kremlin. They have shown that they will stop at no crime and at no treachery. They are the same leaders who, a week after announcing that they had ordered withdrawal of their forces from Budapest, returned with armored divisions and bombers to machine-gun and massacre men and women in the streets.

### THE NEW MACHIAVELLI

The Soviet leaders have not discovered any brilliant new form of diplomacy. The methods they have followed were described more than four centuries ago by Machiavelli:

"It is much safer to be feared than loved, if one of the two has to be wanting. Men in general are ungrateful dissemblers, anxious to avoid danger, and covetous of gain. As long as you benefit them, they are entirely yours, when the necessity is remote; but when it approaches, they revolt. The friendship that is gained by purchase is bought but not secured. Men have less scruple in offending one who makes himself loved than one who makes himself feared; for love is held by a chain of obligation which, men being selfish, is broken whenever it serves their purpose; but fear is maintained by a dread of punishment which never fails. . . . Men are so simple and so ready to obey present necessities, that one who deceives will always find those who allow themselves to be deceived."

Our own proper course lies neither in appeasement nor in extending still more foreign aid to undependable allies. Does our sole reliance, then, lie in keeping ahead of Russia in a desperate and endless armament race? We need not come to so grim a conclusion. There is real hope in an additional course. We can try to convert the Communist countries to capitalism and private enterprise.

### TEACH CAPITALISM

Such a proposal is likely to be greeted by our pseudoliberals with howls of derision. Yet the tactic has been used successfully enough against us. The Russian Communists, by lies and confusions, are constantly making new converts to Communism. The leaders in one country after another turn to government planning, to socialism, to Communism, because they have been led to think this is the way to economic salvation.

What we must do, if conversion to capitalism is to succeed, is to answer the Communists with truth and clarity on every intellectual level. We must point out that government ownership and operation are grossly inefficient that socialism does not create wealth but

impoverishment; that dialectic materialism is nonsense; that the whole class-struggle argument is false; that workers and managers, employees and employers, are essentially cooperators in production; that the whole system of private capitalism is a marvelous system of social cooperation.

These things can only be taught by those who understand them. Western politicians and official propagandists are certainly not the ideal group to teach them. Most of them lack economic understanding and believe in the welfare state. But the stakes, for survival and civilization, are too enormous to abandon the effort in despair. And the outlook is far from hopeless. The conversion of a Djilas in Yugoslavia, the magnificent revolt in Hungary of a whole population subjected to years of indoctrination and terror show what might happen, even within Russia or China, with a little intellectual guidance from the West. ☸

## How to Destroy Jobs

January 20, 1958

Our chief economic danger in 1958 is that we may get inflation and unemployment at the same time. The combination would not be, as some writers seem to think, "something new under the economic sun." The combination has occurred frequently in Europe and in Latin America. It can occur whenever wage rates move upward faster than prices, unduly squeezing profit margins.

The January letter of the Guaranty Trust Co. of New York contains an able analysis of the danger. "Only a few months ago," it points out, "spokesmen for organized labor were criticizing manufacturers for raising prices of their products at a time when sales were tending to decline. [Yet] in December, when the demand for labor had been weakening steadily for four months, the AFL-CIO announced its determination to press for higher wages, shorter hours, and expanded fringe benefits in 1958."

Such policies, as the bank points out, must tend to price union members out of jobs. Unless these policies are corrected, the general business downturn now under way will be needlessly deepened and prolonged, billions of dollars' worth of potential industrial output will be lost, and the entire economy will suffer—labor most severely of all.

### WAGES AS COSTS

Yet union spokesmen declare that employment is declining not because wages are too high but because they are

too low. This is merely a revival of the old “purchasing power” fallacy—the theory that the reason production and employment are not “full” at any given time is that there is not enough purchasing power to take the output off the market. The bank’s letter argues:

“An understanding of purchasing power is impossible without a grasp of the basic principle that every portion of the money value of every commodity and service produced is income, or purchasing power, to someone. Purchasing power is derived from output and, in the final analysis, is identical with output. It may be consumers’ purchasing power in the form of personal income. It may be business purchasing power in the form of net profit after taxes. It may be governmental purchasing power in the form of tax revenue. . . . It follows that purchasing power is automatically maintained as long as output is maintained. . . . The exclusive emphasis upon wages as a source of purchasing power is a fallacy fatal to clear economic thinking. Wage income is, of course, a form of purchasing power, like any other type of income. To the managers who make business decisions and create jobs, however, wages are primarily costs. At a time when cost-price relationships are already tending to make it unprofitable for business concerns to maintain and expand operations and thus to create jobs, nothing could be more short-sighted than to aggravate the difficulty by insisting upon a further increase in the cost of employment.”

#### WAGE RATES VS. INCOME

Though this analysis is correct, there is another and perhaps simpler way of pointing out the fallacy. The error seems to stem largely from a simple confusion between hourly wage *rates* and *total wage payments*, because the word “wages” is loosely used to cover both. It is seldom assumed that if a manufacturer increases his prices his dollar volume of sales will rise in direct proportion. In such a case few people confuse a price with an income. They recognize that a rise in prices, greater than justified by demand, will reduce volume of sales. In the same way a rise in hourly wage *rates*, greater than justified by labor’s marginal productivity, must *reduce* employment and probably *reduce* total payrolls and purchasing power.

The Guaranty Trust Co.’s letter ends with a well-timed warning:

“Spokesmen for the workingman have always been prone to quarrel with the employer’s profits. They have never been able to reconcile themselves to the fact that those profits are really the workingman’s best friend. It is the prospect of profits that creates the job, and it is the realization of profits that maintains the job. . . . When

profits are squeezed and demand is faltering, the attack [on the employer’s profits] becomes a formula for unemployment.” ❁

## Notes on the Budget

January 27, 1958

**Forgotten Billions:** Officially estimated expenditures of \$73.9 billion in the 1959 Federal budget would by themselves constitute record peacetime spending. But in addition there will be expenditures out of government trust funds (mainly for social security and highways) of \$16.4 billion. Even when interfund payments are deducted, this means that actual total expenditures will be more than \$86.7 billion. Expenditures are not reduced, nor is the total burden of taxes, by hiding part of them in special segregated budgets.

**Wishful Thinking:** It seems highly probable that estimates of both receipts and expenditures for 1959 err on the optimistic side. Last year the President made both errors. Instead of the surplus of \$1.8 billion he then promised for 1958, there is a prospective deficit of \$400 million. He now promises a budget surplus of \$500 million for 1959. But if he has made merely the same-size dollar error for 1959 as for 1958, this \$500 million surplus would become a \$1.7 billion deficit. It could even be much larger. In an acknowledged period of declining business, the President wishfully estimates budget receipts from the same taxes at \$2 billion more in 1959 than in 1958. And Democratic leaders (and some Republicans) are demanding even higher spending.

**Nondefense Spending:** It is when we come to nondefense spending that we get our greatest shock. Federal nondefense expenditures recommended for 1959 reach a new high record of \$28.1 billion (not including the \$2.5 billion for the highway program), compared with \$28 billion in fiscal 1958, \$25 billion in 1957, and \$21.2 billion in 1954. If we compare these recommended 1959 nondefense expenditures with those of 1957, for example, we find that they are higher in every major category except “general government.” They are higher, in other words, in foreign economic aid, veterans’ benefits, “welfare,” farm subsidies, natural resources, and housing.

So here, where huge cuts were possible, we have instead mainly increases. In his Oklahoma talk of Nov. 13, the President declared that new expenditures for missiles would have to come out of nondefense programs: “Savings of the kind we need can come about only through cutting out or deferring entire categories of activities. This will be one of the hardest and most distasteful tasks that the coming session of Congress



must face, and pressure groups will wail in anguish." But when the moment came, Mr. Eisenhower himself had little stomach for the task. He has, it is true, asked for some peripheral "welfare" economies. But these, even if enacted, would not mean significant savings until 1960 or later. Yet the tax burden and strain on our resources are enormous, and economies which are always advisable have now become imperative.

**Defense Spending:** There will be an increase of \$3.3 billion in 1959 over 1957 just for missiles, nuclear weapons, etc. Total missile-program spending for 1959 is estimated at \$5.3 billion. (In 1953 we spent only \$1 million on long-range ballistic-missile development.) It may be, as so many congressmen and others are contending, that even these increases are not enough. But it is probable, as the Hoover commissions and Congressional investigations have repeatedly shown in the past, that there is huge extravagance and waste concealed in other parts of so-called defense spending. Total defense spending, in any case (including \$3.8 billion for foreign military aid), is estimated at \$45.8 billion for 1959, compared with \$44.8 billion for 1958 and \$44.4 billion for 1957.

**How to Cut:** There is no real problem in knowing where cuts in nondefense spending could be made. The whole \$4.6 billion farm subsidy is an economic outrage. Most of the \$5 billion foreign-aid program is demonstrably futile. The \$5 billion of veterans' benefits is shamelessly swollen. But all this has been pointed out many times before—to no avail.

One hope, at least, lies in getting some reforms in budget procedure. We should put government appropriation requests on an accrued expenditure basis and grant the President an item veto for appropriation bills. Mr. Eisenhower has asked for both. ❀

## Salvation by Deficit?

February 3, 1958

At his press conference of Jan. 15, President Eisenhower declared that if revenues in the fiscal year 1959 failed to come up to the optimistic expectations of his budget message, the economy would require "a needle rather than a checkrein." And he let it be explicitly understood that by a "needle" he meant deficit financing.

This statement cannot be dismissed as a mere slip of the tongue. The President's 199-page Economic Report expresses the same philosophy, though in a more guarded way. The report pays the customary lip service to "policies that will help prevent inflation" and maintain "a free competitive economy." But

it ends with more than 40 recommendations, nearly all of which, if adopted, would either be inflationary or extend still further the domain of government intervention and creeping socialism. The two outstanding exceptions are the proposals to extend the Trade Agreements Act and to lower price supports on basic agricultural commodities.

## THE ROTTING DOLLAR

The report boasts in its opening paragraph that the nation's output of goods and services in 1957 totaled \$434 billion, and personal income \$343 billion, and that "both were 5 percent larger than in the preceding year." Only later are we explicitly told that "four-fifths of this increase was accounted for by rising prices," and that therefore "in physical terms, the increase was only about 1 percent." This shows the deceptiveness of national income figures. Germany, in 1923, could boast that its national income had increased about a trillion times over its national income in 1913, for the simple reason that inflation had reduced the value of the mark to one-trillionth of its prewar value.

In spite of its length, there is no mention in the report itself of the extent to which the value of the dollar has declined since 1939. But from tables in the back of the report we can find, by making our own calculations, that wholesale prices at the end of 1957 had risen 136 percent as compared with 1939; that the consumers' price index in the same period had risen 105 percent (reducing the purchasing power of the dollar to less than one-half); that the total supply of money and credit, as measured by total bank deposits and currency, increased 260 percent in this period, and as measured by demand deposits and currency had increased by 282 percent.

The price rise, in short, came in spite of a great increase in the production of goods. It has been solely the result of money-and-credit inflation. It is government policy, and not "unwarranted" price or wage increases, that is primarily responsible for this. It is money-and-credit expansion that makes price-and-wage increases possible, if not inevitable.

## FAITH IN DEFICITS

This faith in the efficacy of deficit financing and inflation is apparently even stronger in most of the Democrats in Congress. Representative Wilbur D. Mills, the chairman of the powerful House Ways and Means Committee, thinks that before the end of the year we may have to reduce taxes, "even though it would mean deficit financing," to get us out of the slump.

Yet the belief that employment and sound prosperity depend on or vary with the volume of government spending or deficit financing can be disproved both by

logic and statistics (see this column, *Newsweek*, Oct. 3, 1955). Contrary to nearly everything now being said in Washington, inflation does not necessarily increase employment. It has this effect (following unemployment) only if it makes prices rise faster than wage rates. What is essential is a working equilibrium between wages and prices. When that exists, we can have full employment without inflation. But if wage rates rise faster than prices, squeezing out profit margins, we can have heavy unemployment even with inflation.

Salvation does not lie in deficit financing or monetary inflation. It lies in maintaining fluid and functional relationships between wage rates and prices. We can do this chiefly by ceasing to confer special monopolistic powers and immunities on labor unions. But we cannot squander ourselves into prosperity. And we cannot assure prosperity by still further eroding the value of the dollar. ❁

## Inflation Arithmetic

February 10, 1958

Most of us still give lip service to the ideal of preventing further inflation; yet we advocate the very policies that increase inflation. Even the banking community is not exempt.

A few weeks ago, the Economic Policy Commission of the American Bankers Association proposed a general lowering of reserve requirements against deposits. The reserve requirements against checking deposits are now 20 percent for banks in "central reserve" cities (New York and Chicago); 18 percent for banks in 48 "reserve" cities; and 12 percent for "country" banks. The ABA recommends that these be reduced eventually to only 10 percent against demand deposits for all member banks no matter where located. In addition, it recommends that reserves against time deposits be reduced from 5 percent to 2 percent, and finally that vault cash be counted as part of required reserves.

### FED PLANS

The member banks are not alone in such recommendations. Serious Washington reports indicate that the Federal Reserve Board is planning to increase the nation's supply of bank credit sharply by reducing bank reserve requirements, and has failed to reach agreement merely about the exact timing of the announcement and the specific plan. It is meanwhile significant that the cut in the Federal Reserve discount rate from  $3\frac{1}{2}$  to 3 percent in mid-November was followed by a further cut in late January to  $2\frac{3}{4}$  percent.

The huge inflationary potential in the ABA proposal can be seen from a simple calculation. On Dec. 25, the required reserves of all Federal Reserve member banks came to \$18.9 billion. Calculating these respectively for central reserve city banks, reserve city banks, and country banks, we find that they would have permitted the member banks to make sufficient loans and investments to create demand deposits totaling about \$117 billion. In other words, the average required reserves worked out to about 16 percent of demand deposits. If, now, the member banks are allowed to keep reserves of only 10 percent against demand deposits, they could create demand deposits of \$189 billion—an increase of more than 60 percent in this part of the money supply.

We have still to consider the existing inflationary potential of the Federal Reserve Banks themselves. At one time they were required to keep gold and cash reserves of 35 and 40 percent against deposit and note liabilities respectively. But since 1945 they have been required to keep only 25 percent reserves in gold *certificates* against deposit and note liabilities combined. On Jan. 29, they kept a gold certificate reserve of \$22 billion, or 47.3 percent, against combined note and deposit liabilities of about \$46.7 billion. If they increased their own liabilities to reduce their gold certificate reserves to only 25 percent, those liabilities would go to some \$88 billion. Depending on the percentage of the increase that went into creating deposits for the member banks, those deposits could increase from the present \$19 billion to \$40 billion or even to \$60 billion. If the member banks then kept only 10 percent reserve against deposits, their demand deposits would increase from the present \$117 billion to \$400 billion or even \$600 billion!

### POTENTIAL INFLATION

Several conclusions are suggested by these theoretical calculations. There are enormous inflationary potentialities even under the present Federal Reserve law. These inflationary potentialities could and should be cut off by a change in the law. If the private banking community, the Federal Reserve authorities, or Congress want to cut off these possibilities, this is the place to begin. The big city banks are right when they argue that the present differentials in reserve requirements are obsolete and unfair. But the way to cure this discrepancy is not to lower the reserve requirements for everybody, but to equalize them (over a long period) at the present average level.

The agitation for lower reserves shows the inflationary psychology that follows when the gold standard is abandoned. If the reserves themselves are only paper, even bankers begin to wonder why it is necessary to keep them at all. ❁

## Wage Rates and Jobs

February 17 1958

A day does not pass now without someone in Washington proposing a new inflationary scheme. All these schemes are based on a common set of assumptions. It is taken for granted that under no conditions can the government permit a recession or even a comparatively mild readjustment. It is taken for granted that it is a "responsibility" of government to maintain "full employment" at all times. It is taken for granted that the government not only has the power to do this, but knows exactly how to do it. It can be done, it is assumed, either by heavy government spending, or heavy deficits, or forcing down interest rates, or an increase in the money supply, or all four.

The sole point of dispute among these inflationist groups concerns the exact dose of added spending, tax reductions, or money creation that is necessary to maintain "full employment." The "conservative" inflationists want a comparatively mild dose—just enough to achieve "full employment," but not enough to bring "true" inflation. The lunatic fringe wants to spend money with a steam shovel and to print it on a rotary press.

### WAGE-PRICE RATIO

But all these groups are wrong in their fundamental assumptions. The truth is that neither government spending nor an increase in the money supply is either a necessary or a sufficient condition for the existence of full employment. What is necessary for full employment and prosperity is a proper relation among the prices of different kinds of goods and a proper balance between costs and prices, particularly between wages and prices. When this balance exists, so that the prospect for profits exists, full employment and maximized production and prosperity will follow. When this balance does not exist, when wage rates are pushed above the marginal productivity of labor, and profit margins are doubtful or disappear, there will be unemployment. The presence or absence of monetary inflation is by itself irrelevant.

If the proper relationship exists between costs of production and prices, between wage rates and prices, there can be full employment without inflation. And there will be unemployment even with a rampant inflation if wage rates are too high as compared with prices so that profits are distorted or on net balance negative.

What leads to the great contemporary faith in inflation as the cure-all for unemployment and other economic ills is the fact that under special conditions inflation may raise prices more than wage rates and so restore comparative equilibrium and workable profit margins. After an inflationary boom, there may be a

depression accompanied by a collapse of prices. If labor unions then refuse to accept corresponding reductions in wage rates, a money-and-credit inflation, if not accompanied by a further rise in wage rates, may raise prices enough to restore profit margins, production, and employment.

### WAGE RATE VS. INCOME

But today, we are given to understand, economic adjustment is *never* to be made by reducing wage rates, but *always* by more inflation to raise prices. The unions, going farther, insist that not only must wage rates never be reduced under any circumstances, but that they must be advanced each year, in monetary terms, especially when things get bad, for that will "increase purchasing power."

This argument is, of course, wholly fallacious. It confuses wage rates with total wage payments; it confuses a price with an income. Higher wage rates, by excessively raising costs of production and wiping out profit margins, may create unemployment, and so reduce total labor income. It is in the interest of the whole body of labor itself that equilibrium wage rates should be established that maximize employment and labor income.

But today opinion is confused. One school of thought believes that wage rates *ought* not to be reduced under any circumstances; another school holds that in fact they will not be reduced because unions will never accept a reduction. That is why, unwilling to face up to the need for curbing the union monopoly powers that our labor laws have conferred in the last generation, so many people can see no way out but the dangerous and desperate road of more inflation. ⚙

## Hair of the Dog

February 24, 1958

It is only a few weeks since the President reported that the nation's output of goods and services in 1957 totaled \$434 billion, the highest figure on record. In December 1957, moreover, the average hourly earnings of manufacturing workers, at \$2.11, were also the highest on record. But suddenly, overnight (if you believe the Democratic speeches in Congress), we are in a cataclysmic depression. Mass unemployment and starvation stalk the land, forcing soup kitchens and bread lines. (It is true that official estimates of unemployment rose to 5.8 percent of the labor force in January as compared with 5.2 percent in December.)

The Democratic politicians are almost praying for a depression so they can have the privilege of saving us



from it this November, and again in 1960. And they have not the slightest doubt about the remedy. It is, as you might have guessed, for the government to spend more money. Especially we must start more “public works.” The question is not whether they are needed, but how much “employment” they will provide, and how much they will add to “purchasing power.” It is assumed that every dollar spent by government somehow magically multiplies itself in increasing national income. Given this theory, economy in government is not only unnecessary but antisocial and wicked; and squandering and waste are the height of economic wisdom.

### NO MAGIC IN DEFICITS

It seems necessary to point out all over again that the government-spending theory has been repeatedly disproved in practice. In the fiscal year 1944, the Federal government spent \$95 billion; in the fiscal year 1947, it spent only \$39 billion. Here was a drop in the annual spending in this three-year period of \$56 billion. A budget deficit of \$51 billion in 1944 was also turned into a budget surplus of \$754 million in 1947. Yet instead of a recession in this period there was a substantial increase in employment, wages, and prices. Again, in the fiscal year 1953, the Federal government spent \$74 billion; and in the fiscal year 1955, only \$64 billion. The budget deficit also dropped from \$9.4 billion in 1953 to \$4.2 billion in 1955. Yet in the calendar year 1955 the gross national product increased \$28 billion above that of 1953.

I have repeatedly tried to explain in this column not only that the government-spending nostrum or government-deficit nostrum does not work in practice but that it is theoretical nonsense as well. This leads us to the depression remedy that the “conservatives” and Republicans are now suggesting, which is a cut in taxes. President Eisenhower has said that he would favor a tax cut to brake the recession unless the economy turns up by midyear. Now a tax cut would at least have several advantages as compared with an increase in expenditures. It is a smaller invitation to reckless government spending. A wisely made tax cut, moreover, could increase incentives. But this is not what anybody is suggesting. What is being mainly suggested is an increase of \$100 or more in the personal income-tax exemptions which would take millions of people off the income tax entirely, leaving the confiscatory rates on higher incomes and the excessive rates on job-giving corporations.

### WAGE RATES AND JOBS

The President wisely pointed to the danger of “going too far with trying to fool with our economy,” and implied that he would want such a tax cut only if it would not

be inflationary. But the very purpose of such a tax cut would be to resume inflation. What is proposed, in short, is a cut in taxes without a cut in expenditures, to increase the size of the deficit, and to get “recovery by deficit.”

The worst of all remedies for the recession is that proposed by Walter Reuther and the AFL-CIO. It is a further increase in wage rates to “increase purchasing power.” As I pointed out here last week, a further increase above present peak wage rates would simply increase costs of production, squeeze out more profit margins, price more goods and more labor out of the market, increase unemployment still more, reduce payrolls, reduce labor’s total income, and turn recession into real depression.

The country may well pray to be saved from its saviors. ☸

## Wage Boosts vs. Jobs

March 3, 1958

One would suppose that, before politicians and “experts” rushed forward with sure cures for the recession, they would at least try to discover its causes. They would find most of them in the great length and extent of the preceding boom.

On the investment side, many industries have greatly expanded their capacity in the last few years. They are not planning to expand further until demand comes abreast of enlarged production. On the consumption side, many families have now acquired most of the durable goods they can absorb, and plan merely to replace these as they wear out or become obsolete. Moreover, much of their future buying power is already mortgaged. Installment credit outstanding has swollen from a total of \$2.5 billion at the end of 1945 to \$34.1 billion at the end of 1957—a thirteenfold increase.

The chief effect of installment credit is to enable people to buy right away what they could not otherwise buy until the next year or two. It makes one year more prosperous, in other words, at the expense of its successors. As it grows, the volume of repayments must grow. It is highly probable that the installment repayments in January and February this year exceeded the amount of new credit extended. But would it be wise to try to force up the total volume of installment credit still further?

### BREATHING SPELL

What we are chiefly suffering from today is a hangover from the constant overstimulation of the economy in



recent years—price-support subsidies to farmers for overproducing crops, huge foreign giveaway programs to give a false fillip to export “sales,” huge government mortgage guarantees to overstimulate home-building, grandiose Federal highway programs, constant expansion of welfare payments. When the economy pauses to catch its breath and make adjustments, we are deluged with proposals for more hypodermic injections of inflation: “massive” government intervention, huge new spending for public works, reduction of taxes without reducing expenditures, heavy deficits, further cuts in interest rates, reduction in bank-reserve requirements to increase the money supply.

Yet on one subject there is a great silence. No politician or government economist suggests that some wage rates may have risen to a point where the workers involved are pricing themselves out of jobs. Efforts to prove this statistically, by comparisons with physical productivity, have not been successful. Yet it is easy to show that wage rates have been shooting up far faster than either prices or corporation profits. Average hourly factory earnings increased 56 percent between 1948 and the end of 1957, compared with an increase of 18 percent in the consumer price index. This meant an increase of “real” wage rates in the period of 32 percent. On the other hand, corporate profits after taxes in 1957, at \$20.6 billion, were hardly changed from the \$20.3 billion in 1948. This meant a fall in “real” profits after taxes of 13 percent.

### WAGES AS A COST

With rising unemployment, all the union leaders have to suggest is still further increases in wage rates, to “increase purchasing power.” But this suggestion confuses wage rates with total payrolls. Hourly wage rates are a cost of production. To raise costs still further can only raise prices or wipe out profits, and hence lead to smaller sales, less production, smaller total payrolls, and less employment.

When politicians do admit the possibility of excessive wage rates, it is only to express the pious hope that “labor” will show “restraint” in demanding wage increases. But the chief purpose of our Federal labor laws has been to rescue unions from the natural penalties of lack of restraint. Restraint will not be shown until Congress removes the irresponsible private monopoly powers it has put in the hands of union leaders. This involves a reconsideration of the Norris-LaGuardia Act, the Walsh-Healy Act, the Wagner-Taft-Hartley Act, etc. The present unwritten law is that wage rates must move only upward, and that whenever some of

them become excessive we must increase inflation and depreciate the dollar more and more, to make them payable. ☼

## Buying Unemployment

March 10, 1958

There is real danger that the present recession will be prolonged and intensified by some of the proposals most often put forward to cure it. One of these measures is bigger unemployment compensation for longer periods. The other is payment of still higher wage rates.

Not only labor-union leaders but academic economists have been assuring us that the repetition of a major depression is now impossible, chiefly because of what they are fond of calling “built-in stabilizers.” Foremost among these “built-in stabilizers” is thought to be unemployment compensation. The theory is simple. When there is unemployment, this compensation helps to maintain “consumer purchasing power.” So the recession tends automatically to correct itself.

What this beguiling theory overlooks is that the payment of overgenerous benefits may itself encourage and prolong unemployment. These act in the labor field somewhat like the price-support program in agriculture. Just as the farmer can overprice his crops as long as the government stands ready to buy and store whatever unsold surplus the excessive price creates, so unions can more easily overprice labor the more generous the government plan is to finance whatever unemployment an excessive wage-rate creates.

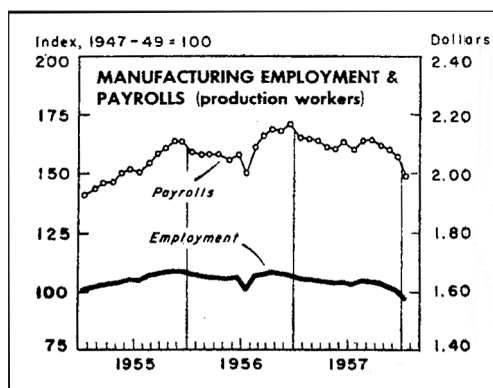
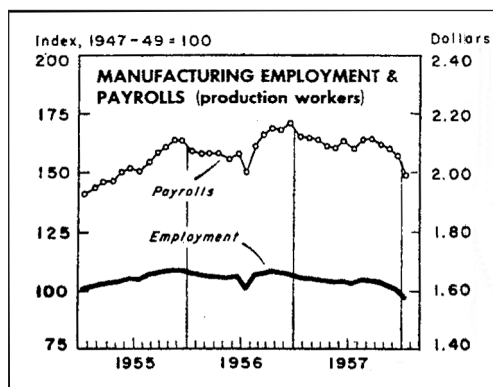
A dramatic illustration came on Feb. 19, when United Automobile Workers delegates voted to ask the Chrysler Corp. to re-establish a 44-hour week for its workers and to lay off those it could not employ full time. The union declared that many of the workers on a short-week schedule (some, they said, on only eleven hours) would make more money through unemployment benefits if they were made idle. A union official declared that with unemployment compensation and supplementary benefits, many would earn two-thirds of their regular pay, about \$58.50 a week. Here is an appeal from a union for more unemployment on the ground that its members can “earn” more by not working than by working!

### WAGE RATE VS. PAYROLL

As for the “cure” of paying still higher wage rates, I have pointed out in several recent columns that when wage rates rise to or above the “equilibrium” level,

further increases do not increase payrolls and purchasing power but *reduce* employment, payrolls, and purchasing power.

The statistical record now proves that this is precisely what has been happening. At the bottom of this column I reproduce two illuminating and significant charts, published without comment, and among other material, in the Feb. 14 issue of *Business Statistics*, put out weekly by the U.S. Department of Commerce. What these charts show is that, for the period they cover from the beginning of 1955, hourly wage rates in manufacturing have been rising steadily month by month to a new peak (about \$2.10) in November, December, and January. But from the end of 1955, both working hours and employment have been falling. Fewer hours and less employment in combination have more than offset higher hourly rates since the end of 1956, and total manufacturing payrolls have taken a sharp dive—of nearly 13 percent—from a maximum index number of 171.4 in December 1956, to 149.5 in January 1958. A rise in wage rates, in brief, can mean a fall in payrolls. ☼



## Adjust—Or Inflate

March 17, 1958

To those of us who lived through the Great Depression, there is a curious familiarity about the schemes put forward to get us out of the present slump. On June 12, 1931, for example, the Chase National Bank of New York published a pamphlet by its economist, the late Benjamin M. Anderson, called "Equilibrium Creates Purchasing Power." Anderson there drew a contrast between two opposing schools of thought. The school to which he adhered found the cause of the slump in "a disturbance of economic equilibrium." The other found its causes in "deficiencies of purchasing power."

The purchasing-power school was inflationist. It advocated "cheap-money policies," farm price supports, and heavy spending on "public works." It argued that "reductions in wages are on no account to be permitted." "The general picture which the purchasing-power school presents is that of production running ahead of buying power." As against this, Anderson advocated the restoration of equilibrium, mainly through adjustments of free and flexible prices and wages. He called for the restoration of a proper balance among the various types of production, among prices, and particularly between prices and costs of production, including wages, so that profits would be possible and stimulate enterprise.

### PRICES AND COSTS

"When goods are produced in proper proportions," he wrote, "they clear the markets of one another. . . . Production itself gives rise to the income which supports consumption. Production and consumption expand together. The 120 millions of people in the United States consume vastly more than the 400 millions in China, because they produce vastly more. . . . The problem is merely one of keeping the different kinds of production in proper proportion. This is accomplished under the capitalist system by the movement of prices and costs. Labor and capital tend to get out of lines where return is low and to move over into lines where return is better. The smooth working of this system calls for flexible prices, competitively worked out, which tell the truth regarding underlying supply and demand conditions."

Anderson went on to point out that the purchasing-power theory was not working. "We have had extremely cheap money for over a year." Inflexibility of industrial wage rates, while prices were falling, had led to increased unemployment. "Real" industrial wage rates between June 1929 and March 1931 had risen 11

percent, indirectly helping to force down “real” farm wages 17 percent.

But, as we know, the purchasing-power school—the inflationist school—won out. We had cheap money, inflexible or rising wage rates, and heavy government deficits for the next ten years. As a result, we also had mass unemployment for the next ten years—until the Second World War finally bailed us out.

### TRIUMPH OF KEYNES

Today the chief ideological change is that there can hardly be said to be two schools of thought. Practically everyone in Washington seems to agree that we can easily float ourselves out of the slump through more inflation. We need merely give ourselves a sufficiently big dose—of increased spending, or tax reduction, or anything else that will produce a whopping deficit. The new Bible is Keynes’s *General Theory*, which denies Say’s Law and ignores any need for specific wage and price adjustments. The Administration disagrees with the Democratic inflationists only about the question of timing. It hopes everything will cure itself in the next few months. If it doesn’t, it promises to take “positive government action”—today’s euphemism for more inflation.

Meanwhile, neither political party calls attention to the fact that as factory wage rates have risen, unemployment has increased and payrolls have fallen. Neither party asks whether even massive inflation can restore employment as long as powerful unions have escalator contracts under which wage rates soar faster than living costs, preventing restoration of profit margins or lowering of prices. The only remedy proposed is bigger and longer unemployment compensation to help strong unions preserve upward-spiraling wage rates. ❁

## Stampede to Inflation

March 24, 1958

The President began with some sound and brave words in his March 8 letter to the Republican leaders of the House and Senate. The function of the government, he declared, “must necessarily be to stimulate private production and employment, not to substitute public spending for private spending, nor to extend public domination over private activity.” He expressed concern “over the sudden upsurge of pump-priming schemes” urging “wholesale distribution of the people’s money in dubious activities under Federal direction.” Having said all this, he proceeded to recommend a whole nest of pump-priming schemes, with wholesale distribution

of the people’s money on loans, grants, and spending on dubious projects.

Just two days before this letter, the Federal Reserve Board ordered another cut in the discount rate from  $2\frac{3}{4}$  to  $2\frac{1}{4}$  percent. Two days after the letter, Vice President Nixon suggested a tax cut that would enlarge the deficit. Most of the Democrats in Congress complain only that these inflationary measures are not big enough. Even Republicans demand the scalp of Secretary Benson for suggesting some moderation and sense in farm price supports.

Both political parties, in short, are getting panicky. Both are urging policies which, though reckless, are unlikely to cure unemployment.

### INSURANCE VS. RELIEF

The President recommends that Federal funds be used to “extend for a brief period” unemployment compensation benefits for workers who have exhausted their existing benefits. Some Democrats call for an extension to 42 weeks, compared with the 26 weeks or less in most state laws.

Our whole system of unemployment benefits needs basic reexamination. Present proposals may pervert what set out to be an unemployment “insurance” system into a glorified Federal relief system. Once the Federal government starts contributing funds, it will be called upon for more and more. The “insurance” may become a Federal relief system permanently. If we recall the history of “emergency” farm relief, the “emergency” RFC (now alias SBA), “temporary” veterans’ benefits, “temporary” foreign aid, and the constant expansion of Federal grants-in-aid, we will not deceive ourselves about the “temporary” character of the present proposal.

The purpose of unemployment insurance is to mitigate the hardships of unemployment without increasing or prolonging unemployment itself. We are losing sight of the second half of this objective.

### ESCALATORS VS. JOBS

But the reason why even reckless inflationary measures may not cure the present unemployment is that the basic cause of the unemployment is being ignored. This is the excessive height to which the hourly wage rates of powerful key unions have now been pushed. As Prof. Ludwig von Mises recently reiterated: “The height of wage rates at which all those eager to get jobs can be employed depends on the marginal productivity of labor. . . . If wage rates, either by union pressure and compulsion or by government decree, are raised above this height, lasting unemployment of a part of the potential labor force develops.” Even Sen. Paul Douglas, in 1934, when he was still an economist, concluded in



a 625-page book on wages: "If wages are pushed up above the point of marginal productivity, the decrease in employment would normally be from three to four times as great as the increase in hourly rates so that the total income of the working class would be reduced."

Today, not only do excessive money wage rates show no signs of being adjusted to present realities; they are still rising because of built-in escalator contracts. In its December *Monthly Labor Review*, the Department of Labor tells us that "approximately 4 million workers in about 530 major bargaining situations will have their pay increased in 1958 by amounts specified in agreements negotiated in earlier years." This includes not only built-in "productivity" or other automatic increases, but automatic increases based on the rise of the Consumer Price Index. Even further monetary inflation cannot cure unemployment by raising prices when it increases wage rates even more. ❁

## Insuring Unemployment

March 31, 1958

The history of unemployment insurance in this country is a classic illustration of how a "welfare" program keeps expanding almost automatically while the safeguards against abuses keep dropping away.

The Social Security Act, under which the individual states were in practice forced to set up unemployment-insurance plans, was passed in August 1935. The average weekly benefit of \$10.54 paid to the unemployed in 1940 has about tripled to \$30.11 in January of this year. This rise in itself is not surprising. The average weekly wages of covered workers went up from \$26.60 in 1940 to slightly more than \$80 now. But the same inflation that raised wages forced up benefit payments.

Most states started by requiring a waiting period of two to three weeks before benefit payments began; the waiting period in all states has now been reduced to one week or less. More significantly, in 1937 the most frequent maximum duration period for the payment of unemployment benefits was sixteen weeks; by 1955 this had risen to 26 weeks.

### INSURANCE INTO RELIEF

New York State has just jumped the maximum weekly benefit from \$36 to \$45. It is variously proposed by the Administration and by Democrats that the Federal government pay unemployment benefits out of its own funds or deficits for up to thirteen or sixteen weeks beyond the maximum provided by the states. Anyone acquainted with the realities of politics or the "welfare"

history of the last 25 years should know that once the Federal government adopts this "emergency" proposal its contribution will probably be permanent and increasing. It will turn an insurance plan into thinly disguised relief.

An ideal unemployment-insurance plan, if it could be realized, would be one that reduced the hardships of unemployment without increasing or prolonging unemployment itself. But there is a strong presumption that our present system tends to increase unemployment in three main ways:

1—It weakens the incentive of many workers to get a new job as soon as possible. The overwhelming majority of American workers, of course, prefer work to unemployment and charity. The number of outright shirkers or chiselers is probably negligible. But there is a less negligible number of people whose incentive to get a new job is or will be reduced as their unemployment benefits are increased or prolonged.

A U.S. Department of Labor pamphlet suggests that the weekly unemployment-benefit payment should be "at least 50 percent of weekly wages," and that for low-wage earners it ought to be "70 percent or more." Suppose a textile worker has been earning \$60 for a 40-hour week, is laid off, and gets \$42 a week, or 70 percent, as unemployment benefit. Even if he could get his old full-time job back at \$60 before the expiration of his benefits, he may ask himself: "Why should I work for only \$18 a week?" And if he could get the same hourly wage for a 27-hour week, he is asked to work, as he sees it, for less than nothing.

2—The present unemployment-insurance systems put a direct penalty on earning money by work. In most states a man is disqualified from unemployment benefits if he earns more than \$5 or \$6 a week during the period. This foolish deterrent could be removed by the simple device of reducing his benefits by, say, 50 cents for every \$1 of outside earnings. In this way he could always increase his income by at least half the net amount he earned from casual work. At no point would he be out of pocket for taking such work. The states might treat "supplementary unemployment benefits" in the same way. To make (as 40 states now do) no deduction whatever for them, discriminates in favor of members of strong unions and subsidizes increased unemployment in such unions.

3—The most important way in which unemployment insurance increases unemployment is indirect. It subsidizes the unemployment created by excessive wage rates and relieves the pressure on powerful unions to bring wage rates down to the level at which full employment could be restored. It may be gravely doubted, in



short, whether unemployment insurance, as it exists at present, is a “built-in stabilizer.” ⚙

## Priced Out of Jobs

April 7, 1958

Both political parties in Washington are convinced that there is only one way to cure existing unemployment, and that is by a still further and bigger dose of inflation. Both want to make our paper money cheaper and more plentiful. Both want a thumping deficit, “to increase purchasing power.” The only points they can’t agree on are exactly how big they want to make this deficit, whether they should get it mainly by more spending or by a tax cut, and exactly when they ought to start. But when it comes to the principal cause of the present recession, which is the excessive wage rates of the strong unions, and the escalator clauses they have been able to impose, Washington is deaf, dumb, and blind. It seems ready to adopt any inflationary scheme, however reckless, rather than suggest that these wage rates be readjusted.

### WHERE THE JOBS ARE

Let us see where present unemployment is mainly concentrated. The government has estimated that 7.7 percent of the civilian labor force was unemployed in February. (Seasonally adjusted, the percentage was 6.7.) Here is the percentage of unemployment in some leading industries in February, and the latest available figures on hourly earnings of the workers employed in them:

	Unemployment	Hourly Wages
Construction	21.3%	\$2.99
Automobiles	15.7%	2.48
Primary metals	13.5%	2.56
Mining	11.5%	2.61
Fabricated metals	10.9%	2.22

The average unemployment in all manufacturing industries in February was 9.8 percent; the average hourly earnings of workers in them was \$2.10. In nondurable manufacturing industries unemployment averaged 8 percent and hourly earnings \$1.92.

Such comparisons, of course, are not in themselves conclusive. Wage rates in certain industries may average higher than in others because of differences in skills, mechanization, growth, etc. But it is at least significant

that present unemployment tends to be above average where wage rates are above average and highest where wage rates are highest.

The comparison is still more significant between the incidence of unemployment and of escalator wage contracts. I quote from the December Monthly Labor Review of the U.S. Department of Labor:

“At the beginning of 1958, almost ten years after the first agreement between General Motors and the United Automobile Workers to provide annual improvement factor increases and cost-of-living escalation, more than 4.3 million workers will be covered by cost-of-living escalator clauses. To a substantial degree, these same workers are also scheduled to receive deferred [the department’s euphemism for contractually mandatory] increases, since the majority of the workers covered by contracts incorporating provisions for deferred increases are also covered by automatic cost-of-living escalator clauses. . . . At the end of 1957, cost-of-living escalator provisions covered a greater number of workers than at any previous period.”

The article ends by pointing out that about half the wage increases granted in 1957 to railroad, automobile, and basic-steel workers came from cost-of-living escalators and half from other mandatory increases.

The leaders of the strong unions who have been able to exact these automatic wage increases have no intention of adjusting their labor contracts to the existing purchasing power of consumers of the products their unions make. They insist that their unions’ excessive wage rates and unemployment be subsidized out of Federal funds poured into state unemployment-insurance plans. They demand that the government pump more paper dollars into the economic system so that others can buy the products they make at the soaring prices that their own excessive wage rates have made necessary. They have no stake in stopping inflation because their own members are protected by escalator wage contracts. But their remedy, though reckless, will not work. For if further inflation raises purchasing power and prices it will also raise escalator wage rates still more, making a further rise in the price of key products necessary. And so *ad infinitum*. ⚙

## Insurance or Politics?

April 14, 1958

Since its inauguration more than twenty years ago, our state unemployment-insurance program has steadily expanded while safeguards against abuses have been relaxed. Since 1940, as I have already pointed out

(*Newsweek*, March 31), the average weekly benefit paid to an unemployed man has almost tripled. The waiting period before payments begin has been reduced from two or three weeks to a week or nothing. Since 1937 the most frequent maximum duration period of payments has been extended from sixteen weeks to 26.

But if the plan that the President recommended to Congress on March 25 is enacted (not to speak of worse Democratic plans) the state unemployment-insurance program will lose its last title to be called insurance. It will become a discriminatory relief system and a political football.

#### FAILURE AS RELIEF

The Administration program cannot be justified, in fact, either as insurance or relief. Considered as relief, it makes no test of need. As my colleague Raymond Moley pointed out last week, it would ignore the estimated 2.2 million unemployed who have received no unemployment compensation, but would provide additional payments to the less than 300,000 who have already received and exhausted their benefits. Considered as relief, it would also be rankly discriminatory. The sums paid under state plans are related to previous wages and not to family needs. Typically, the maximum weekly benefits are three times as great as the minimum benefits (e.g., \$30 down to \$10). The Administration plan would not change this basis. Considered as relief, payments even under the Administration plan would stop at the end of a maximum, say, of 39 weeks, even to those still out of work.

On an insurance basis, benefits may be properly proportional to the previous period of employment and the previous weekly wage—especially if the taxes paid in are also proportional. But any insurance justification for present differences will be destroyed if the Federal government suddenly orders an increase in the duration of benefits and tosses a huge added amount into the reserves to pay them.

The Administration plan is bad from no matter what standpoint it is considered. The President declares that “such legislation should not encroach upon the prerogatives which belong to the states.” The proposed legislation clearly encroaches upon these prerogatives. It *orders* the states to increase the duration of their payment of benefits by 50 percent. Ironically, under such a flat proportional plan the states that have already had the longest benefit payment periods are ordered to lengthen them the most and the states that have had the shortest benefit payment periods are asked to lengthen them the least. In addition to discriminating between unemployed in different states, the Administration plan discriminates in favor of the present unemployed (if it

is really temporary, as it professes to be) as against the unemployed in future years.

Not the slightest evidence is offered that the states need these forced loans. State unemployment reserves now total \$8.5 billion. This is where they stood at the end of 1956, their highest point except for the \$8.9 billion at the end of 1953.

#### IMPROVISED SCHEME

The Administration proposal has obviously received no serious thought. It is a hastily improvised political gesture. Even as an “anti-recession” measure it is dubious. It may tend to prolong unemployment by reducing the incentive of many workers to get a new job as soon as possible, and by reducing pressure to adjust excessive wage rates.

The plan would destroy unemployment insurance. It would put the Federal government permanently into relief masquerading as insurance. Unemployment insurance as such can only be preserved if it is strictly separated from relief. What we really need now is not to desert the insurance principle but to return to it more strictly. A big step in that direction might be to have the workers themselves contribute directly toward the premiums, as they have always done in Britain, and in our own Federal old-age insurance system (OASDI). ❁

## Is the Dollar Doomed?

April 21, 1958

Three events temporarily helped to slow down the panicky stampede in Washington to more inflation. The first was Bernard Baruch’s testimony before the Senate Finance Committee that “we must prevent further deterioration of the credit of the United States” and “reject all tax reduction and pump-priming proposals which require deficit financing.” The second was President Eisenhower’s warning the next day against hasty actions, including a major tax cut, to combat the slump: “You just are not going to get the economy . . . inspired and stimulated just by spending Federal money.” The third event was the Easter recess of Congress.

Unfortunately there are still serious factors on the other side. Baruch’s testimony was spoiled by his implied endorsement of price and wage controls. Within a few days of the time the President sounded his warning, he advocated an ill-considered increase in unemployment insurance, signed a \$1.8 billion “emergency” housing bill, and abolished even the 2 percent down-payment requirement on mortgage loans guaranteed by the Veterans Administration. Congress rushed through

several huge spending bills, including one to pump \$1.8 billion in new Federal and state funds into highway construction, and the Federal Reserve Board proposed legislation to permit still further expansion of bank credit.

### HALF ALREADY GONE

A warning of where such measures are likely to lead us, as well as an arresting summary of where they have already taken us, has just appeared in a study by Franz Pick: *The United States Dollar: Requiem for a Dead Half* (Pick Publishing Corp., N.Y., 30 pages, \$25). "Whenever a currency loses more than half of its value in less than a generation," he begins, "the unit is doomed. The United States dollar, in seventeen years . . . has declined to less than half of its 1940 buying power. This erosion cannot be halted."

I hasten to say that I do not accept Pick's defeatism concerning the American dollar. That defeatism seems to stem from a strange contradiction in his own economic philosophy. Though he is unsparingly sarcastic about the deceptions and consequences of inflation, he shares with the inflationists the belief that, "at a stable purchasing power of the dollar, the country cannot maintain full employment." Neither theory nor history justifies this conclusion.

But Pick tellingly sums up what inflation has already done. It has debased the national debt. While that debt increased from a nominal dollar value of \$49 billion in 1940 to \$273 billion now, the purchasing power of this \$273 billion debt, in 1940 terms, is only \$133 billion. The government's creditors, its bondholders, have been cheated out of billions in purchasing power.

### GNP ILLUSIONS

One of the great illusions created by inflation concerns the growth of the national economy. Thus the gross national product (GNP) was estimated in 1940 at \$101 billion and in 1957 at \$433 billion. Here is an apparent growth of 330 percent. When the lowered purchasing power of the dollar is allowed for, this becomes a real increase of only 111 percent. When the increase in population is allowed for, this falls to a real per capita increase of only 61.2 percent. This, Pick tells us, means a per capita growth of gross national product in stable dollars "averaging not more than 3.6 percent per year." Even Pick here understates his case. For if we figure, as we should, the average rate of increase *from each year to the next*, it falls to only 2.85 percent. Inflation has worked no miracles of real expansion.

I have said that Pick is wrong in contending that the erosion of the dollar *cannot* be halted. But no one familiar with the history of the last quarter century, or with the present Washington climate, will have the hardihood to argue that it *will not* be. The whole present

clamor for increased spending on public works, major tax reductions, deficits, cheaper money, is a clamor for more inflation, for further deterioration of the national credit and further erosion of the dollar, in the desperate and delusive belief that this is the only alternative to recession and unemployment. ❁

## Deficits vs. Jobs

April 28, 1958

I pointed out here in the issue of March 17 that, after 1930, "We had cheap money, inflexible or rising wage rates, and heavy government deficits for the next ten years. As a result, we also had mass unemployment for the next ten years—until the second world war finally bailed us out." As we are trying to adopt now precisely the remedies that failed in the '30s, let us look at that period in more detail. Here are the deficit, number of unemployed, and percentage of unemployed to the total labor force, year by year in that decade:

In the following table the deficits are for fiscal years ending on June 30; the unemployment is an average of the full calendar year. Spenders, no doubt, will try to find a partial negative correlation between the size of the deficit and the number of unemployed; but the central and decisive fact is that heavy deficits were accompanied by mass unemployment. If we translate the foregoing figures into 1957 terms, we find: The average deficit in this ten-year period was \$2.8 billion, which was 3.6 percent of the gross national product of the period. The same percentage of the gross national product of 1957 would mean a deficit of \$15.6 billion. The average unemployment of the ten-year period was 9.9 millions, which was 18.6 percent of the total labor force. The same percentage of unemployment today would mean 12.6 million jobless instead of the present 5.2 million. So much for the effect of deficits as a cure for unemployment.

	Deficit (billions)	Unemployed (millions)	Percentage of Unemployment
1931	\$5	8.0	15.9%
1932	2.7	12.1	23.6
1933	2.6	12.8	24.9
1934	3.6	11.3	21.7
1935	2.8	10.6	20.1
1936	4.4	9.0	16.9

	Deficit (billions)	Unemployed (millions)	Percentage of Unemployment
1937	2.8	7.7	14.3
1938	1.2	10.4	19.0
1939	3.9	9.5	17.2
1940	3.9	8.1	14.6

Another point to be noticed in this table is that in the ten years from 1948 to 1957 inclusive, average unemployment was 4.3 percent of the total labor force. Yet this period was one of unusually high employment, even of "labor shortage." But if four persons out of every 100 are "normally" unemployed, then the present "abnormal" unemployment is only three persons out of every 100. This is serious, especially for those directly concerned. But it hardly justifies reckless deficit spending or further dilution of the dollar in an effort to cure it. We could more profitably look at the relation of key wage rates to prices and consumer demand.

In this article I have taken official unemployment estimates at their face value. Next week we shall try to find how accurate these estimates are.

## THE RECORD

	Employed (in millions)	Unemployed (in millions)	Percentage of Unemployment
1941	50.4	5.6	9.9%
1942	53.8	2.7	4.7
1943	54.5	1.1	1.9
1944	54.0	.7	1.2
1945	52.8	1.0	1.9
1946	55.3	2.3	3.9
1947	57.8	2.4	3.9
1948	59.1	2.3	3.8
1949	58.4	3.7	5.9
1950	59.7	3.4	5.3
1951	60.8	2.1	3.3
1952	61.0	1.9	3.1
1953	61.9	1.9	2.9
1954	60.9	3.6	5.6
1955	62.9	2.9	4.4

	Employed (in millions)	Unemployed (in millions)	Percentage of Unemployment
1956	64.7	2.8	4.2
1957	65.0	2.9	4.3
1958*	62.3	5.2	7.0

\*1958 figures are for the month of March. ⚙

## How Many Jobless?

May 5, 1958

When, in the 1930s, some economists began seriously discussing just what is statistical "unemployment," old Hugh Johnson retorted in one of his angriest columns: "Ask the man who's out of a job!" But the problem does not yield to mere invective. You can find lots of people in Miami or Las Vegas who have no particular job but are not worried. Millions of women and children are without jobs. In fact, the population of the United States is about 173 million, and as there are only some 62 million employed, there must be today not merely 5 million, but 111 million "unemployed."

For the statisticians, however, the "unemployed" consist only of those in the "labor force" who are not employed. Just how is the line drawn between the 67.5 million who are counted as part of the labor force and the 105.5 million who are not?

Here is how the U.S. Bureau of the Census describes how it decides: "Monthly estimates of the population of working age [14 years and over] showing the total number employed, the total unemployed, and the number not in the labor force are obtained from a scientifically selected sample of about 35,000 interviewed households in 330 areas throughout the country." So the estimate of unemployed is in large part based on a sample of only one in every 1,400 households in the country.

### SHIFTING 'LABOR FORCE'

The bureau goes on: "The unemployed total includes all jobless who were looking for work." How is the number of such persons estimated? From replies to the interviews. What constitutes realistically looking for work? The interviewers must rely in large part upon the realism of the replies. The labor force is not even a constant percentage of the total ("noninstitutional") population. In July of last year it was 60.6 percent; but in December only 58.1 percent.

Some paradoxical results emerge. The last monthly report, for example, opened as follows: "Employment rose by 300,000 between February and March . . . while



unemployment was unchanged.” How is that? The layman would naturally expect that if employment rose 300,000 in March unemployment would drop that much. The statisticians’ answer is that the “labor force” increased by that much.

The “labor force” increases partly by census estimates of the population reaching working age, etc., but also partly by changes in people’s *decisions*. Suppose a man has a good job, with a wife at home and a son and daughter in college. He loses his job, whereupon not only he, but his wife, his son, and his daughter start looking for work. Because one person has lost his job, four persons are now “unemployed.” So “unemployment” goes up faster than employment goes down. There were 1.4 million more persons employed this March than in 1954; yet 1.6 million more were unemployed.

### DEFINING UNEMPLOYMENT

Let’s turn now to the Department of Labor: “Effective January 1957, persons on layoff with definite instructions to return to work within 30 days of layoff and persons waiting to start new wage and salary jobs within the following 30 days are classified as unemployed. Such persons had previously been classified as employed. . . . The combined total of the groups changing classification has averaged about 200,000 to 300,000 a month in recent years.” So the “unemployed” have increased some 300,000 since the end of 1956 simply by a change of definition!

Among the conclusions to be drawn from all this are: (1) The government figures of unemployed are merely *estimates*, subject to error. (2) Statistical unemployment of several millions, or 3 or 4 percent, may exist even when there is a definite “labor shortage.” (3) Not every “unemployed” person is necessarily in distress. (4) The existence of some statistical or “frictional” unemployment is not necessarily an evil. There are always some people who prefer to be temporarily unemployed rather than accept or keep a job or wage that does not suit them. In a free economy, 100 percent “full employment” is never realized. But in such an economy there is always a *tendency* toward full employment, if prices and wages are flexible, without the need for perpetual inflation. ❁

## ‘Curing’ the Recession

May 12, 1958

It is not surprising to find politicians like Harry Truman and Lyndon Johnson blaming the recession on Republican “tight-money policy” and demanding

“bold, prompt, confident action”—which always turns out to mean deficit spending and inflation. What is far more disturbing is to find committees of businessmen or economists plumping for the same inflationary policies.

I cite as outstanding examples the Committee for Economic Development and the Rockefeller Brothers Fund. The program committee of the CED called in March for increased spending for “public works,” but above all for “a large temporary cut in personal-income taxes to stimulate private spending.” This would mean “a cut of one-fifth in personal-income-tax rates”—or about \$7.5 billion a year. “It is necessary that in a recession the budget be allowed to run a deficit. . . . The small decline in the money supply . . . should be halted and reversed.” If this is not a recipe for inflation I do not know what to call it. The Keynesian ideology concerning the cause and cure of crises is swallowed whole.

### INFLATION AS REMEDY

Turn now to the report of the Rockefeller Brothers Fund. It has some sensible things to say about long-range tax reform and farm policy. It even has a sentence saying: “Business and labor must exercise restraint, the former in its pricing policies, the latter in its wage demands.” But it too recommends inflation as the cure for the slump. It advocates an immediate tax cut (amount unspecified). It wants to “accelerate public works,” and to set up “a permanent shelf of projected public works.” And it wants the Federal Reserve System to “*increase* the supply of money and credit as long as the economy is declining.”

Prof. Seymour Harris of Harvard, himself a Keynesian, has hailed the Rockefeller report as “virtually 100 percent Keynesian.”

For the long run, in fact, the Rockefeller report has even more inflationary implications than the CED report. The CED report looks only a year ahead, and proposes a tax cut only for that period. But the Rockefeller report looks forward for ten years, and what it looks forward to is steadily expanding government controls and government spending and a steadily expanding welfare state. It comes up with the remarkable discovery that an economic “growth rate” of 5 percent a year will lead to a bigger growth in ten years than a 3 percent rate or even a 4 percent rate. It assumes without argument that the way to get higher growth rates is for the government to spend more (and to tax us more to pay expenditures).

Of course if the government continues to inflate the currency and debase the dollar it can get (*in dollars*) any “growth rate” it wants. Let us remember that if there had been no inflation since 1939 (i.e., no increase in prices) the same real gross national product in 1957

would have been counted, not as \$434 billion, but as only \$194 billion.

### RESTRAIN BOOMS

It is gratifying to turn to the sober analysis that one finds in the April survey of the Guaranty Trust Co. of New York. "The best way to prevent recessions," the bank reminds us, "is to prevent booms, and the best way to minimize recessions is to restrain booms. . . . Booms generate unsound tendencies, including unwarranted expectations of future markets, excessive inventory accumulation, distorted price and cost relationships, outright speculation, credit strain, disproportionate production of different types of goods, and ill-advised investment."

The recession, in brief, is itself part of a necessary corrective process. "The longer management clings to old methods, old products, and old pricing policies, the longer it will take to recover the lost markets. The more tenaciously labor insists upon maintaining or raising the cost of employment, the less employment there will be. . . . Sound incentives are derived from the removal of artificial restraints, not the administration of artificial stimulants."

If space permitted, I should be tempted to quote this admirable discussion in full. But the rare voices making such sober diagnoses are drowned out by the swelling chorus of the inflationists. ❁

## To Encourage Earning

May 19, 1958

I have already pointed out (*Newsweek*, April 14), as has Raymond Moley (April 7), what is wrong with the Federal extension of state unemployment insurance proposed by the President on March 25 and already passed by the House. If this measure becomes law, it will destroy the principles of state unemployment insurance and put the Federal government permanently into relief masquerading as insurance. Many conservatives in the House felt themselves compelled to vote for this ill-considered measure in order to stave off the incomparably more reckless and demagogic bill offered by the Democratic leadership.

In *Newsweek* of March 10 I gave one illustration of how the unemployment insurance system, even as it stands, directly tends to increase the very unemployment against which it insures. The United Automobile Workers asked the Chrysler Corp. to reestablish a 44-hour week for its workers and to lay off those it was employing only part time, on the ground that the latter

would make more money per week through unemployment benefits if they were made completely idle.

### PENALTY ON WORKING

This sort of consequence is the result of defects in the state unemployment insurance laws that the states themselves could remedy without the need for Federal intervention. Few people seem to realize that present state unemployment insurance systems put a direct penalty on earning money by work. In the great majority of states a worker is disqualified from unemployment benefits if he earns more than \$5 or \$6 a week during his benefit period. A handful of states have different formulas, but all of them put a positive penalty on earning above a certain amount.

This foolish deterrent to part-time work and earnings could be removed by a simple device. For every \$1 of outside earnings that a man received during his benefit period, his weekly benefit could be reduced by 50 cents. In this way he could always increase his net weekly income by at least half the amount he earned from casual work. Suppose the weekly benefit to which the unemployed worker was entitled was \$30. Then if he earned \$10 by casual work in a given week he would not be completely disqualified from unemployment benefit but would receive \$25, making his net income \$35. If he earned \$20 his benefit would be reduced to \$20, making his net income \$40. If he earned \$30 his benefit would be reduced to \$15, making his net income \$45.

### PREMIUM ON IDLENESS

It probably would not be wise to continue this formula beyond the point at which a man's outside earnings exceeded his benefit. The primary purpose of unemployment insurance, after all, is to provide some minimum income during unemployment, not to supplement income from employment. But even if outside earnings exceeded the amount of the full benefit payment, it would be cruel and stupid, and defeat the purpose of unemployment insurance, to disqualify the unemployed worker completely. From that point on his weekly benefit could simply be reduced by the full amount of his additional earnings. This would mean, for example, that if a worker entitled to a \$30 benefit earned \$35 his benefit payment would be reduced to \$10.

To prevent the formula I have suggested from being exploited as a subsidy for part-time work by any collusion between unions and employers, unemployment benefits, as now, should begin only after a worker had been laid off. And any part-time earnings from employment *by the same firm that had laid him off*, if they occurred during the benefit period, would be fully deducted against the benefit payment.

Under such a system the worker would at least never be out of pocket from accepting part-time or casual work, and in most cases he would gain by it. The states should, of course, treat “supplementary unemployment benefits” in the same way, deducting, say, 50 cents of unemployment benefit for every \$1 of SUB. To make (as some 40 states now do) no deduction whatever for SUB, not only discriminates in favor of members of a few strong unions, but discriminates in favor of income from not working against income derived from work. ❁

## The Foreign-Aid Fiasco

May 26, 1958

The treatment of the Nixon party in South America—the face-spitting, the rock-hurling, the desecration of the American flag—is an end result of our policy of total foreign entanglement in the last dozen years, and in particular of the foreign-aid program.

It may not be possible to determine the exact extent to which the South American riots were inspired by organized Communist plots directed locally or from Moscow, and to what extent they reflected genuine national feeling. In any case, the Communists won another major propaganda victory, and our own world prestige suffered another major blow. The Nixon tour was primarily an effort to woo South American good will and to secure a demonstration of it. Instead, our Vice President and his wife were insulted, physically attacked, and shamefully humiliated. The rioters successfully showed that they hate us and do not fear us. From this standpoint it is hard to deny the Moscow radio’s triumphant claim that the Nixon tour was a “fiasco.”

### WE CAN’T BUY ALLIES

A few months ago (Jan. 13) I quoted here a passage from Machiavelli in which he pointed out that, in international affairs, “it is much safer to be feared than loved, if one of the two has to be wanting” and that “the friendship that is gained by purchase is bought but not secured.” James Burnham, in *National Review* (May 17), has taken an even more appropriate quotation from the same source: “When things are so managed in a government, that the neighbors purchase its comity, and make themselves its pensioners, ‘tis a certain sign of the potency of that government; but when the neighbors on the contrary receive money from it, ‘tis as infallible a sign of its weakness.”

From the very beginning, one of the main purposes of our foreign-aid program, in whatever euphemistic forms it may have been expressed, has been to buy the friendship and good will of other nations—to buy allies. It has not only failed to do so; it has done the opposite. We overlooked the elementary fact that the recipient of alms feels humiliated in accepting them. They wound its national pride; they advertise its dependence on the giver. The recipient resents any *quid pro quo* or any conditions, even when these are in its own interest. One of the signs carried by the mob that attacked Nixon in Lima was PERU IS NOT FOR SALE. Even if this was composed by Communists, they could count on it to inflame anti-American feeling.

### GET RICH BY GIVEAWAY?

For many other reasons our foreign-aid policy has produced exactly the opposite results from those its supporters expected. To woo a country with bribes or their equivalent is to make that country feel that any alliance is primarily for our benefit rather than for its own. It regards such offerings as a sign of weakness. We lose respect by them. We have extended foreign aid to some 80 countries. The crowning irony is that nations that should have got not a cent from us are resentful and embittered because they get less than other nations.

The “economic” case for foreign aid is even worse. If there had been no economic foreign-aid program, countries wishing private American capital for development would have had to adopt sound political and economic policies to attract it. Government-to-government foreign aid has made this unnecessary. It has supported and prolonged foreign-exchange control, inflation, confiscatory taxes, and Socialism. And so it has on net balance retarded, not advanced, world production and economic recovery.

The *reductio ad absurdum* of all the economic arguments for foreign aid has been solemnly put forward by the Secretary of State. “The great bulk of our Mutual Security funds—over three-fourths,” he said on March 24—“are spent in the United States. . . . To cut these funds would be to cut employment here at home.” This is the argument that we get rich by giving our goods away. We could, of course, “create” the same employment by making the same goods to dump into the sea. If we want to subsidize our exporters, there are cheaper ways of doing it than giving away \$100 for every \$5 or \$10 of net profit that exporters might get from added foreign sales. ❁



## Reform Our Labor Law

June 2, 1958

The demand for real reform in our labor laws has reached a point where the Democratic Majority Leader, Lyndon Johnson, has promised action at this session in the Senate. But there is little prospect of action by the House and, if legislation does emerge, no prospect whatever that it will be anything but innocuous or positively mischievous.

The dilemma of the present recession is that nothing but politically unpalatable measures will permanently help, while nothing but politically popular measures are being proposed. A score of measures have been taken, and scores more are pending, to increase deficit spending and inflation. These measures may have a temporary effect in increasing national-income figures. But they merely pile up greater difficulties for the longer future. And they divert attention from the need to curb the present power of the giant industrywide unions to impose wage rates which either disrupt production and employment or force continuous inflation to try to make such excessive wage rates payable.

### LABOR LAW 'HOLIDAY'

This big-union power could be curbed, not by any "repressive" or "punitive" or "union-smashing" legislation, but merely by repealing most of the New Deal Federal labor legislation passed since 1932. This legislation has turned the Federal government, in effect, into a union-organizing agency and put the full machinery of government behind the union monopolists.

None other than John L. Lewis has several times proposed that we try a "holiday" of a year or two from present Federal labor legislation. But this proposal is probably too far out of accord with the way in which public opinion has been conditioned in recent years to be regarded as politically feasible. Something close to the same practical result, however, could be achieved by following the recommendations of Prof. Sylvester Petro in a recent pamphlet, *Personal Freedom and Labor Policy*, published by the Institute of Economic Affairs at New York University.

While a good many union leaders have been shown to be cheap crooks and embezzling scoundrels, he points out, still more laws against stealing will do no good; we already have such laws. They deal with only the most superficial symptoms of the things that have gone wrong in labor relations. We need to return to basic common-law principles.

### FREE EMPLOYEE CHOICE

Petro declares that the legal reforms needed "may all be subsumed under a single heading: Unqualified supremacy of the principle of free employee choice." In detail, this would require:

1—A broad prohibition of restraint and coercion by employers and unions of the right of employees to make up their own minds on the question of union membership or participation in strikes.

2—A specific provision of law to the effect that picketing, even when "peaceable," is subject to ban when it has or is intended to have coercive effects, either physical or economic.

3—A specific declaration that the ban on restraint or coercion applies to the economic coercion implicit in all "agreements" proposed by unions or employers which make union membership or nonmembership a condition of employment. ("Integrity demands that if unions be allowed to impose compulsory unionism agreements, employers must be allowed similarly to impose nonunion agreements.")

4—A clear prohibition against secondary boycotts.

5—Emphatic repeal of the exclusive-bargaining, majority-rule principle. This would include a positive statement that unions shall be the exclusive bargaining representatives of only those workers who expressly delegate such authority to them. The present statutory and doctrinal requirement, imposing a legally enforceable duty upon employers to bargain only with majority unions, would then need to be deleted.

Finally, Petro adds, defects in labor-law administration and enforcement are as grave as the defects in the law itself. He would repeal all anti-injunction legislation, abolish all labor-relations boards, and return administration of justice in labor relations to the courts. ❁

## Trade, Yes; Aid, No

June 9, 1958

Perhaps nothing this country could have done could have prevented the crisis in France. The diseases of French democracy are of long standing. In 1872, in a preface to his *English Constitution*, Walter Bagehot pointed out that the French Assembly "is divided into parties and into sections of parties" which habitually "scream"; that "real discussion is impossible," that the French "Parliament can neither choose men nor measures"; that, as the French Premier would not have "the power of dissolving the Assembly . . . the Assembly



would be always changing its ministry, that having no reason to fear the penalty which that change so often brings in England, they would be ready to make it once a month."

The defects of the French system were never corrected. The Fourth Republic is (was?) more unworkable than the Third. Even in his desperate last-minute proposals for constitutional reform, Premier Pflimlin never dared ask for the unequivocal power of dissolution. It was precisely the pathological fear in France of the man on horseback that led to the built-in executive weakness which caused the return of the man on horseback.

### FUTILITY OF AID

Not only has our postwar policy in France proved to be futile, but serious question must be raised whether it did not actually help to precipitate the crisis. Passing over our political interference and considering economic measures alone, if we had not so freely poured in government economic aid, and sponsored such unsound institutions as the International Monetary Fund, with its support of exchange control and artificial currency rates, France would have had to try to attract private capital. In these circumstances, it would not have plunged so heavily into draining, socialistic adventures. It would have had to abandon paper-money inflation and to stabilize the franc.

Much the same might be said of the end results of our aid to South American countries. As in France, that aid has proved to be futile either in preventing currency deterioration or in getting them to like us. Yet the response of the Administration to demonstrated failure, to insults and violence, has been to suggest still more aid! As James Burnham summarized the situation in *National Review* (May 31), how can "a nation that abandons its consuls—like Angus Ward—to Asian jails, that stands passive while its soldiers die slowly in Siberian slave camps, its aviators are brainwashed in filthy Chinese cells, its planes shot down by an Adriatic gangster, its diplomatic establishment smashed and burned, its flag cursed," command respect? "If we do not respect ourselves, why should others respect us? And the nation's response to the Nixon rocks? Abjectly confess how badly we have behaved. Pour out more money to the nations that have allowed these things to come to pass."

### DESCRIPTION OF TRADE

Yet there is one respect in which foreign nations do have a just complaint against us on economic grounds. This concerns our trade policy. It concerns our farm policy of first trying to make our farm exports arbitrarily expensive by crop controls and support-prices, then disrupting and demoralizing foreign markets and production by

dumping our surpluses abroad at absurdly low prices. It concerns the vagaries of our government stock-piling and price-support for foreign metals. It concerns our policy of keeping out imports by excessive tariff rates or actual quotas. It concerns our sudden boosts or threatened boosts of tariffs whenever foreign competition seems on the point of succeeding.

We do not owe France or any South American nation any free gravy at all. Our giveaway program costs us dearly but does them no good. It merely degrades our relations. But we did owe and do owe France, Latin America, and every free country freedom to trade with us, on settled and predictable terms. And we should adopt lower tariffs not as a favor to them, but primarily in justice to our own consumers, who should be able to buy what they want where they can get it on the best terms. In brief, we should adopt seriously and literally the slogan that has received so much empty lip service in recent years: Trade, not Aid. ☼

## How to Increase Jobs and Payrolls

June 16, 1958

There are mounting indications that the recession has been flattening out. A few important industries have been turning upward. Even more clearly hopeful has been the turn in political thought. Only a couple of months ago the great majority of labor-union leaders, politicians, "research groups," and academic economists who got into print were shouting that the only way to stave off disaster was an immediate massive public-works program and/or a huge tax cut of \$5 billion to \$10 billion or more to give us a thundering inflationary deficit.

Though much harm has been done by the inflationary spending programs that Congress so hastily approved (and that already give us a prospective deficit for the coming fiscal year of more than \$10 billion), we have been at least temporarily saved from much worse consequences by the firmness of Secretary Anderson and (after initial wavering) of President Eisenhower. There has not for a long time been so admirable an example of economic sense and political courage as the President displayed in his speech of May 20. I quote some outstanding sentences:

"Reckless expenditure in the name of economic stimulation is both wrong and self-defeating. . . . I would like to nominate for oblivion . . . the idea that the consumer is not price conscious any more . . . the notion that without paying the piper in higher prices, we can as a nation overpay ourselves for what we produce . . . the

idea that large annual wage increases can be regarded as a matter of course. . . . And, finally, we must be disabused of the thought that a competitive enterprise economy can be free of all loss, failure and disappointment, and that government can take all the bumps out of the road of business."

### BLOCKS TO ADJUSTMENT

A free-enterprise economy is self-adjusting. But it must be permitted to adjust. Much of the recent improvement in the business picture has been the result of the adjustments that have already taken place—in some better products, some lowered production costs, and especially in inventories. But the chief stumbling block to further adjustment and recovery is the excessive wage rates of some industrywide unions and the insistence of these unions on still greater wage boosts.

Outstanding examples exist in the steel, electrical, and automobile industries. For half a year the steel industry has been operating at only about 50 percent of capacity. The normal adjustment of a free economy to such a situation would be a reduction of steel prices to stimulate and restore demand. But on July 1 (as the third installment of wage boosts called for in the current three-year contracts), wages of the United Steelworkers union are due to go up another 20 cents an hour or so. The unions obdurately refuse to forgo this automatic increase. So the companies are planning to raise steel prices to meet the added cost.

### GM WAGE PATTERN

In 1955, General Electric negotiated five-year agreements with more than 100 unions. These agreements not only provided a cost-of-living escalator arrangement, but substantial wage increases in addition which come automatically regardless of what happens to the cost of living and regardless of whether there is prosperity or recession. "Now," the company has said, "we look ahead to the fourth and largest increase yet, just when we are trying to pull ourselves out of recession. This increase will be a deterrent to the development of the better product values which are needed for recovery and re-employment." The company has also expressed the opinion that "any [general] wage increase at all now holds back recovery."

The wage-contract pattern which General Electric was forced to follow in 1955 was set by the General Motors formula of 1948. This combined automatic cost-of-living increases with automatic "annual improvement" increases. Together these have already reached a total of 90 cents an hour.

Thus the chief "beneficiaries" of this wage formula have been a few great industrywide unions. But what Walter Reuther and the automobile, electric, and steel

unions are now chiefly suffering from is too many victories. It is mainly where wage increases have gone farthest that there is heaviest unemployment.

Those of us who have insisted on the need of wage adjustment to promote enduring recovery are sometimes accused of wanting to "squeeze down the workers." Such an accusation can be honestly made only by those who fail to understand either what is being proposed or what the real effect of the proposal would be. It is not being suggested that wages should be cut generally or by, say, some flat uniform percentage. What is being proposed is that the wage rates should be cut only of the still-employed members of those top-level unions who are monopolistically profiteering at the expense of higher living costs for all the rest of the workers. And the purpose of this wage-rate cut is not to reduce the purchasing power of the class of workers whose wage rates would be cut, but to increase their living standards and purchasing power. The purpose, in brief, is to cut certain hourly wage rates in order to increase total employment and payrolls.

### WAGE RATE VS. PAYROLL

What has been happening under the steadily mounting hourly wage rates in manufacturing was shown in this column of March 10. The situation has become even more striking since then. Whereas average hourly gross earnings increased from \$2.05 in December 1956 to \$2.11 in April of this year, manufacturing payrolls fell from an index number of 171.4 in December 1956 to 139.6 in April of this year. In other words, an increase of 3 percent in wage rates has meant a fall of 18 percent in wage payments.

The word "wages," in short, is ambiguous, and may mean two entirely different things. A cut in the price of labor may be necessary for a rise in the employment and total income of labor. Failure to understand this elementary distinction has prevented many workers from recognizing where their real interests lie. About 20 percent of the automobile workers are unemployed because Reuther's wage victories have priced American cars into a lower volume of sales. The remedy is clear. ❁

## U.S.A. vs. U.S.S.R.

June 23, 1958

One of the groundless myths encouraged by the Russian sputnik is that Khrushchev is on the verge of achieving his boasts of "catching up and surpassing the United States in per capita production" and "conquering capitalism with a higher standard of living."

Allen W. Dulles, director of the Central Intelligence Agency, made a speech on April 28 which seemed to give color to this claim. He declared that in the recent rapid growth of the Soviet economy, "at a rate roughly twice that of the economy of the United States . . . we have the most serious challenge this country has ever faced in time of peace."

Now all published Soviet figures are designed primarily as propaganda, not as objective information. In *Newsweek* of May 27, 1957, I discussed here the careful study by Prof. G. Warren Nutter covering 37 leading industries from which he concluded that "Soviet industry seems still to be roughly three and a half decades behind us in levels of output and about five and a half decades in levels of per capita output." He has now published a supplementary study (*American Economic Review*, May 1958) emphasizing the growth rate of the Soviet economy in the short period of 1950 to 1955. He calculates that the annual growth rate in the Soviet economy in these five years ranged from 7.7 percent to 11.7 percent as compared with an annual growth rate in the same five years in the U.S. of only 4.6 percent. This is apparently the comparison that so impressed Allen Dulles.

#### PRODUCTION COMPARED

But just how significant is this comparison? Germany and Japan have shown equally striking growth rates following catastrophes. And the United States, in the war period 1939–43, showed the astonishing annual growth rate of 21 percent, based on the Federal Reserve index of industrial production, and even of 10.5 percent based on Geoffrey Moore's index of industrial-material production. This wide difference even in American indexes shows how tricky and elusive growth-rate comparisons can be even when they are honestly and conscientiously compiled.

The most nearly reliable comparisons we can make are of physical output. A pamphlet just published by the National Industrial Conference Board of New York (*Economic Comparisons, U.S.A., U.S.S.R.*, \$1.50) shows that in Russia there is one agricultural worker for every 10 sown acres as against one worker for every 60 sown acres in the U.S. Yet Russia produces only a third as much meat, half as much sugar, and half as much grain per capita as the U.S. The Russian occupies less than a fifth as much dwelling space as an American. "In the U.S.S.R.," said a study prepared for the Joint Economic Committee of Congress, "most families have only a single room in which all members sleep."

#### OVERALL VS. MILITARY

Even these comparisons ignore quality. Once an economy gets beyond the subsistence level, economic

growth—in food, clothing, housing, amenities—is reflected less and less in quantitative terms and more and more in qualitative terms. We must question, therefore, the conclusion of Professor Nutter that there is "a long-run tendency . . . for the industrial growth rates to slow down, or retard, as the level of production gets higher." Physical growth rates slow down; but not necessarily economic growth rates in the wider sense. All belief that Russian Communism can compete with American capitalism in overall growth must be dismissed as baseless.

But this does not mean that we can be complacent about the Russian military threat. Allen Dulles declared that the Russian gross national product in 1950 was about 33 percent that of the United States, and had increased to about 40 percent in 1956. Suppose, for the sake of argument, we accept these comparisons as meaningful. We are spending about one-eighth of our national income on defense. Suppose Russia is devoting one-half of its own national production to war purposes. One-eighth of 100 is only 12½, but one-half of 40 is twenty. Such a hypothetical comparison reminds us that a much inferior economy can outmatch us in military growth by a more determined and ruthless concentration on such growth. ☸

## Preventive Cold War

June 30, 1958

In an all-out war between this country and Soviet Russia there would be no victor. If Communist Russia attacks us first, with nuclear missiles, we may have less than a few hours' warning. It will be impossible to prevent appalling destruction and loss of life. It will be small consolation to know that we may have enough striking power left to devastate Russia also.

Perhaps the greatest problem mankind has ever faced is how to prevent such a war. One indispensable way is to keep even and if possible ahead in nuclear striking power. The Russian leaders must know at all times that any attempt on their part to attack us, no matter what its initial success, will be suicidal for them.

There is no substitute for this necessity. Those who like daydreams may put their faith in securing an agreement for the abolition of atomic and nuclear weapons. But there is no reason to suppose that the Russian leaders would ever keep such an agreement. Its chief result would be to give the West a false and perhaps fatal sense of security. It is easy to talk of guarantees through a "foolproof inspection system." But the more we consider what would have to be done to assure a really



airtight inspection in totalitarian areas like Russia and Red China, whose leaders are dedicated to our destruction by any wile or stratagem, the more unrealistic and unfeasible the whole proposal becomes.

### CONVERT THE COMMUNISTS

Faced with this desperate dilemma, what can we do? We must seek to undermine the will of the Communists to destroy us. Massive retaliatory power would only partly achieve this goal. We must dissolve the Marxian ideology. We must do nothing less than try to convert the Communists to capitalism.

Our own ideology has already been so undermined by Communist and socialist propaganda that most of our officials will regard such a goal as fantastic. For more than 40 years Communist propaganda has been successfully converting increasing numbers in the Western world either to Communism or to the halfway house of "democratic socialism." At best our own counterpropaganda has been sporadic, apologetic, defensive and usually inept and incompetent.

The basic reason is not organizational. The basic reason is that our officials have themselves only a feeble faith in and a confused understanding of the virtues and strength of free private enterprise. They already half suspect that the Communist and socialist systems may be more productive than our own. How else can one account for the flood of statistical and economic fallacies from such official agencies as the CIA and the State Department, warning us, not of Russian military output, but of total overall production, and calling the economic challenge "the most dangerous of all," more dangerous even than the threat of war? How far such a belief is from the truth, how enormously comparisons of production and of living standards are in our favor, I tried to show in this space last week.

### OUR WILL TO RESIST

For years Soviet Russia has been conducting a systematic cold war upon us. Its primary purpose has been to sow dissension, to undermine our faith in our own economic and political institutions, to encourage appeasement among us, to weaken our will to resist—in short, to soften us up as easy prey to a hot war or even to make any hot war unnecessary for their final victory.

And they have been incredibly successful so far. Not until a few years ago did most of us even realize that this cold war existed. Most of us still treat it as a figure of speech rather than as a reality. Yet if we hope to avoid an unlimited nuclear war we must recognize the existence of a cold war and wage it systematically, intelligently, and untiringly. The facts and the ideological weapons are on our side if we know how to use them. We must convince our own people, we must convince

the democracies of the West, we must convince the socialists and neutralists of the East, and finally we must try to convince even the Communists themselves, that a free-enterprise system is infinitely superior to a socialist or Communist system for production, for social cooperation, for peace, and for freedom. ☸

## Preventive Cold War: II

July 7, 1958

Just when our own official propagandists were warning us that Russian Communism was outpacing American capitalism in overall production, Khrushchev announced another major reform in the Soviet agricultural system that is interpreted as a step toward "the farm-commodity market of capitalist countries."

Harry Schwartz of *The New York Times* describes it as follows: "In essence, the decision indicates that the key lesson learned by the Soviet agricultural officials who visited the United States three years ago is now being applied to the collective farms. That lesson is simply that the market forces of supply and demand, price and cost, profit and loss are more effective stimuli for an efficient agriculture than the government exhortations and orders the Soviet Union has relied upon for three decades."

Whether the new reform does in fact go as far as this will be better known as more details become available and further decisions are announced. But there can be no doubt that Khrushchev, in spite of his daily denunciation of capitalism, has been moving in the *direction* of the capitalistic free market. This is shown in his attempts to decentralize industrial production decisions, to permit collective farms to own rather than rent tractors, and to set up what he calls a planned system based on "incentives."

### WHY WE ARE LOSING

It is true that the new system will be still far from a free market. The government will still set an arbitrary price and will still fix compulsory production or delivery "quotas." Unfortunately, we cannot contrast our own system too sharply with this. We too, in agriculture, have abandoned the market system, at least for so-called "basic" commodities. These are supported by an arbitrary government-set price which creates wasteful surpluses and diverts land, labor, and capital from more needed output.

But with the growth of welfare statism at home, our own bureaucrats have come more and more to accept the socialist premises. That is why they are impressed by fallacious comparisons of Russian production with our



own. That is why they believe that the road to world salvation lies in government-to-government foreign economic aid. That is why they are not only willing but eager to subsidize India's socialistic Five Year Plan, an obvious imitation of Russian models.

And that is one of the main reasons why we have so steadily been losing the cold war. For this cold war is chiefly a war of propaganda. It is a struggle for men's minds. And, if our leaders have only a feeble faith in our own system, if they do not understand its virtues and how to explain them, if they do not understand the Marxist philosophy and its weaknesses, they are putty in the hands of the trained dialecticians and determined propagandists of Moscow.

### EDUCATE THE RUSSIANS

Marshal Zhukov once told General Eisenhower that the Soviet system "appealed to the idealistic" whereas ours appealed "completely to the materialistic." "I was very hard put to it," the President confessed at a press conference a year ago. "I had a very tough time trying to defend our position." Two months ago Khrushchev told our American ambassador that when the Communists win the economic competition with the capitalistic world, "we shall also re-educate you." And Ambassador Thompson merely stared at the floor with a faint smile.

Yet it is we who, for our own survival, must re-educate the Russians. It is their philosophy that is materialistic; it is the Western philosophy of economic, political, religious, and cultural freedom that is idealistic. If our economic system is also immensely more productive than Communism, it is precisely because it releases intellectual and spiritual energies.

A subordinate organization like the Voice of America, with its effort to penetrate the Iron Curtain by radio, can perform only a minor role in explaining all this. It must be explained at the summit. Our political leaders must know the right things to say. And, like their opposite numbers in Russia, they must say them persistently, systematically, daily. The fact that such a program will not cost billions or even millions is not a good reason why it can be neglected. ❀

## Government by Favor

July 14, 1958

There cannot be two opinions regarding the impropriety of Sherman Adams's relations with Bernard Goldfine. Goldfine paid hotel bills for Adams of more than \$2,000, gave him a vicuña coat, loaned him an Oriental rug worth \$2,400. Adams communicated with the Federal Trade Commission and the Securities and Exchange

Commission regarding cases involving Goldfine, made an appointment for him, received an FTC memorandum, and transmitted it to Goldfine. These actions, in combination, were more than "imprudent," as Adams confesses; they were improper.

There is a curious parallel between the defenses now offered for Adams and those put forward centuries ago for Sir Francis Bacon. Bacon himself admitted accepting presents from suitors in cases pending before his court, but his defense was that they had not influenced his decision! He insisted that he was "the justest chancellor . . . since Sir Nicholas Bacon's time" and this, as the *Encyclopaedia Britannica* puts it, "on the plea that his intentions had always been pure and had never been affected by the presents received." Macaulay ridiculed this defense in his famous essay in 1837. "It is plain," he wrote, "that, long before Bacon was born, the accepting of presents by a judge was known to be a wicked and shameful act, that the fine words under which it was the fashion to veil such corrupt practices were even then seen through by the common people."

### THE NIXON DEFENSE

The strangest defense of Adams's actions is that put forward by Vice President Nixon, who argues that members of Congress not only have a right but a duty to intervene with Federal agencies in behalf of their constituents. "It is proper for a member of Congress to write or call an agency in order to get information. It is proper to ask for justice for a constituent. . . . [Otherwise] we would wind up having a dictatorship by bureaucracy."

Let us see. Nearly all the Federal agencies involved are called "quasi-judicial" agencies. Suppose they really were judicial agencies; suppose they were courts. Would Nixon regard it as proper for a congressman to write or call a Federal judge "to ask for justice" for a constituent? Such a request would be improper and insulting. It is taken for granted that a judge will dispense impartial justice to all parties before his court, and not merely to those for whom a special request has been made by a congressman. Would Adams have thought it proper to call a judge presiding in a case involving Goldfine and ask about the status of the case or arrange an appointment for him? The question answers itself.

Why, then, are the Federal quasi-judicial agencies considered fair game? Why is it thought not only right but necessary that individual congressmen or outside officials should intervene and put pressure on them in behalf of individual constituents or "lifelong friends"? Why are the agencies considered a real or potential "bureaucratic dictatorship"?

## RIGHT OF APPEAL

The answer is that this is the way Congress has set them up. They are part of the vast growth of government power and intervention in the last few decades. Whenever Congress has not known how to solve a problem it has set up a new agency and delegated broad discretionary powers to it. A judge is bound by the law; his function and duty is to interpret and apply known law to particular cases. But the executive agencies, with their vast discretionary and quasi-legislative powers, and their exemption, over wide areas, from judicial review or reversal, are free to be arbitrary and capricious. This is government by special favor.

Many of the Federal agencies set up in recent years are both needless and pernicious. Those that are not abolished outright should have their irresponsible discretionary powers drastically cut down. Aggrieved parties before them should always be free to have recourse, not to a particular congressman or "an old friend," but to the courts. They should be entitled to appeal from either questionable factual findings or punitive rulings. These principles should be applied to the FCC, the FTC, the SECM the ICC, the NLRB, and the whole bureaucratic jungle. ❁

## Inflation Disrepute

July 21, 1958

The effort to create a common European market calls attention to the radical reforms necessary in present-day economic and monetary policy even to move toward such a goal. The International Chamber of Commerce recently issued a statement dealing with the monetary problems of the European Economic Community. Among the major recommendations two stand out:

1—The member governments should agree not to ask their central banks for new credits "save in exceptional circumstances recognized as such in accordance with agreed criteria, by a competent body designated by them."

2—The present claims on governments held by the central banks should be gradually transformed into negotiable securities bearing interest rates to make them attractive on the international monetary markets.

The purpose of the first recommendation is obviously to try to stop deficit spending by governments, financed by monetizing of new government debt. The purpose of the second recommendation is to restore liberty of action and transferability of assets to the central banks.

## HOW FAR FROM FREEDOM

It is instructive to notice that the best experts of Europe are growing skeptical of the blessings of deficit spending and monetary inflation just when Washington has decided that this is the way to cure any recession. The chairman of the commission that prepared the ICC statement was Maurice Frere, formerly head of the Central Bank of Belgium. Among those who cooperated with him were Emmanuel Monick, formerly governor of the Bank of France, Herman Abs of the Deutsche Bank, Camille Gutt, former managing director of the International Monetary Fund, and other distinguished European bankers.

There is no doubt whatever that if the recommendations of the ICC were followed they would constitute an immense step toward currency stability and greater freedom of international trade. Yet they also emphasize how far away the "free" world, with all its beautiful talk about international cooperation and common markets, still is even from the amount of freedom and international cooperation that existed prior to the second world war, not to speak of the amount of freedom and international cooperation that existed prior to the first world war.

The most immediate international monetary need is the restoration of full currency convertibility—to any amount, and at any rate that those who wish to exchange currency find mutually agreeable. This convertibility could be restored overnight. All that is needed is that the governments of the world should permit it. But this is precisely what the International Monetary Fund and exchange control exist to prevent.

## FORWARD TO GOLD

It is true, of course, that with practically every country on a paper-money basis, and subject to varying degrees of inflation, there would be wide fluctuations in the exchange rates between currencies. But these would be cured if the countries returned to a gold standard.

The final paragraphs of the statement by the ICC declare wistfully that the reforms it recommends "should result in creating among the common-market countries a 'monetary community' which may perhaps lead them one day, when political conditions make it possible, to a single currency. This would be the last stone crowning the edifice." But this "single currency" was, in effect, what virtually the whole world enjoyed, under the international gold standard, prior to 1914. When every currency unit was freely convertible on demand into a specified weight of gold, there was a *de facto* common currency. The ICC statement declares

that a single currency today would be “premature and artificial” until nations “coordinate and harmonize their monetary policies.” It was precisely the requirement of constant gold convertibility that forced them to coordinate and harmonize their monetary policies prior to 1914. No elaborate international bureaucratic machinery was necessary.

In currency matters the world of 1958 has an enormous distance to go before it can even catch up with the nineteenth century. ❁

## Piano and the Stool

July 28, 1958

In 1936, Prof. Jacob Viner, reviewing John Maynard Keynes's new book *The General Theory of Employment, Interest, and Money*, ventured a prediction that has proved, at least in part, remarkably prophetic:

“Keynes's reasoning,” he wrote, “points obviously to the superiority of inflationary remedies for unemployment over money-wage reductions. In a world organized in accordance with Keynes's specifications there would be a constant race between the printing press and the business agents of the trade unions, with the problem of unemployment largely solved if the printing press could maintain a constant lead and if only volume of employment, irrespective of quality, is considered important.”

There may be some doubt whether the problem of unemployment has been “largely solved.” But we have certainly been trying to solve it since 1936 in accordance with Keynes's specifications, and we have certainly embarked upon a race between the printing press and the trade unions.

Take the current recession. There has been some recovery from the bottom. Moderate increases have occurred in industrial production, retail sales, housing starts, the factory work week, and total employment. Particularly striking has been the maintenance of personal income, the rise of farm income, and the continued high level of consumer spending.

### PLANNED INFLATION

But it is precisely the maintenance of high personal monetary income, in a period of smaller output, that points to the existence of inflation. With the index of industrial production down about 10 percent from a year ago, wholesale prices have risen and the consumer price index for this May was 3.3 percent higher than

in May of 1957. The development that has caused most optimism in some quarters—the recent rise of the stock market to new high levels for 1958—finds a more plausible explanation in the fear of further dollar-erosion than in the trend of corporate earnings.

The 1958 inflation, like all inflation, is not the result of some inescapable plague. It is the deliberate creation of governmental policy. Part of this is the approval by Congress of inflationary spending programs, to be paid for by a deficit expected to reach \$10 billion to \$12 billion in the current fiscal year. Part of it is the result of Federal Reserve policies reducing bank-reserve requirements and forcing interest rates once more down to ultra-low levels (with Treasury bills yielding less than 1 percent). These policies have been reflected in an increase in total bank deposits and currency of \$10 billion between April this year and a year ago.

### WE ADJUST TO REUTHER

But has all this inflation worked? Has it, in fact, cured unemployment? True, the official estimate of employment was 920,000 higher in June than in May. Yet because of the flood of new graduates looking for jobs, the estimate of unemployment rose to 5.4 million, a seventeen-year high. This unemployment is still largely concentrated in such industries as automobiles and steel, with the steel industry still operating below 60 percent of capacity. American automobiles and steel are being priced out of a full-capacity market by high prices caused by excessive production costs. Yet instead of any move to lower wage rates to adjust to reduced demand, the powerful nation-wide unions in these industries have been forcing wage rates to new high levels.

A famous European clown used to have an act in which he would try to play a grand piano but find himself persistently thwarted because the stool was always in the wrong place. Whereupon he would try futilely to push the piano around to adjust it exactly to the stool. This is the Keynesian prescription. This is how we are trying to cure the present recession. We have legally made the unions so powerful that they can dictate their terms to the nation. Instead of, say, some 10 percent of the workers adjusting their excessive wage rates to the realities in their own industries, 170 million people are being forced to pay higher prices for everything in an effort to adjust the whole economy to the demands of the Reuthers and McDonalds. Meanwhile most of our politicians remain studiously ignorant of the real situation. ❁



## 'Have-Not' Countries?

August 4, 1958

Surely the overturn in Iraq has supplied one more lesson in the folly of foreign aid. The economic and military aid that we poured into Iraq has not only gone down the drain, but we shall be lucky if these resources are not ultimately used against us.

Once more it has been proved that our foreign aid does not buy allies or even friendship. Once more it has been proved that it does not turn a country "away from the Communist camp." In a book I wrote eleven years ago, *Will Dollars Save the World?* I pointed out that "the comparatively easy decision to give more of the American taxpayer's money away cannot be regarded as a substitute for the hard political and diplomatic decisions that any serious program of countering Russian Communistic aggression must involve."

The political folly of the foreign-aid program is exceeded only by its economic folly. One of its economic assumptions is that foreign aid will "raise living standards" and so "discourage Communism." The statistical evidence fails to show that any recent rise in living standards has discouraged Communism. Nor is there any convincing evidence that the rise in living standards actually achieved in Europe or the Middle East in the last decade has been mainly the result of our foreign aid. On the contrary, whatever rise in living standards has occurred in the Middle East in the last ten to twenty years has been mainly brought about by the exploitation of oil.

### WHERE THE OIL IS

The tremendous significance of this has been almost wholly lost on our own statesmen and on our socialistic "liberals." One of their favorite themes in the last decade is that this country is rich because it has been blessed far beyond others with "natural resources," whereas the "underdeveloped" countries are poor because nature has given them no natural resources. So we, the Have nation, must give to the Have-Not nations to satisfy their "legitimate aspirations."

Turning to reality, let us look at one of the most vital of all national resources for modern industry, wealth, warfare. Last year the Middle East produced 23 percent of the oil output of the free world. True, great as this is, it was only about half the oil brought to the surface in the United States, which accounted for 47 percent of the free-world total. But when we turn from current production to oil *reserves*, we get the reverse of this picture. According to the estimates of *The Oil & Gas Journal*, Middle Eastern lands contain proven oil reserves totaling 170 billion barrels, or 71 percent of the

West's still untapped crude petroleum, compared with known U.S. reserves of only 33 billion barrels, or only 14 percent of the free world's holdings. The Middle East, in other words, has more than five times the known oil reserves of the United States.

### RESULT OF CAPITALISM

Which then are the Have, which the Have-Not nations? In proportion to its area and population, the Middle East may be more richly endowed than ourselves, not only with oil, but with total natural resources. Some day, instead of giving aid to the Middle East, we may be asking for it.

Why, it may be asked, if the Middle East is so richly endowed, is its general standard of living so far below our own? I suggest that the reason is because America has followed the way of private competitive enterprise, the way of freedom and capitalism, whereas in the Middle East, generally speaking, private property and private capital, foreign or domestic, has never been safe from burdensome regulations or taxes, seizure, or socialism. Even the oil development that the Middle East has had has been almost wholly achieved through discovery and exploitation by American or British private enterprise.

But none of these facts has seemed to make the slightest impression on the semisocialist ideology of our Washington bureaucrats, whose cure for every crisis in foreign relations is still bigger American handouts. It is not easy to see how we can extricate ourselves gracefully, and without losing face, from our present awkward involvement in the Middle East imbroglio. But it is still not too late to reappraise some of the preconceptions and policies that chronically lead to such involvements. ☼

## Time-Deposit Inflation

August 11, 1958

The recent dramatic rise in the stock market has been hailed by many as a sign that the recession is over. But the rise has been quite disproportionate to the recovery in business. The Dow-Jones industrial average rose from 420 on Oct. 22 last year, and from 437 on Feb. 25 this year, to 505 on Aug. 1, an overall increase of 20 percent.

The Federal Reserve index of industrial production, on the other hand, which stood at 142 last October, was only 130 in June of this year, a decline of about 8 percent. Unemployment was estimated at 2.5 million last October and is now estimated at about 5 million.



Well, it may be said, the stock market isn't supposed to reflect actual conditions at the moment, but anticipated conditions; it is forecasting further recovery. But perhaps what the stock market really is reflecting is current credit inflation and the belief in a further shrinkage in the dollar.

The continued existence of inflation is plain enough not only from the rise in the stock market while unemployment is substantial and the level of output is down, but from the rise of both wholesale and retail prices in the face of this lower activity. The dollar has lost about 3 cents in purchasing power in the last twelve months. And it has done this because government (and Federal Reserve) policy has been increasing the number of dollars.

### SWOLLEN MONEY SUPPLY

There are many economists and statisticians who contend that this has not occurred. The money supply, they argue, consists of demand bank deposits and currency outside of banks. The total of demand deposits, they point out, was \$104.8 billion at the end of May 1957 and only \$105.8 billion at the end of May this year. For the same period, currency outside of banks was \$27.9 billion in 1957 and \$27.8 billion in 1958. So for the twelve months the total money supply was almost unchanged.

This picture alters, however, as soon as we take account of *time* deposits. Between the end of May 1957 and the end of May this year, these increased by nearly \$10 billion.

Here is where the expansion of bank credit—the inflation—has taken place. Since the end of 1951, demand deposits have increased only 8 percent and currency outside of banks only 5 percent, but time deposits have increased from \$61.5 billion to \$94.6 billion, or 54 percent. It is common to think of time deposits as “savings.” That is why their growth has been rather complacently regarded. But another interpretation may now be called for.

### 1958—AND 1928

There is a striking parallel between the present situation and that exactly 30 years ago. In June of 1928 Benjamin M. Anderson analyzed the situation in two bulletins for the Chase National Bank. “Since July of 1927,” he wrote, “there has been an immense expansion of bank credit flowing into the securities market. . . . The most conspicuous effect of cheap money and bank expansion has been in the speculative rise in the prices of securities and real estate, but this rise has in itself had a very marked effect upon the volume of consumer demand.” He went on to show how the Federal Reserve authorities, by lowering the rediscount rate and by other means,

had brought about an expansion of bank credit which had taken the form primarily of increased time deposits. In the seven years ending in April 1928, whereas the net demand deposits of the reporting banks of the Federal Reserve System had increased 34 percent, their time deposits had increased 135 percent.

“The fact,” he continued, “that an immense expansion of bank credit has taken place, unneeded by commerce and industry, has made it inevitable that a high percentage of this increase would take the form of time deposits rather than demand deposits. . . . The greater part of time deposits in great cities” are not true savings deposits but “represent the temporarily idle funds of business corporations. . . . Most of the growth of the time deposits . . . is a product of bank expansion rather than of savings.”

All this applies to the present situation. Bank credit has expanded. Out-of-line wage rates have not been adjusted. So we have a booming market with continued unemployment. ❁

## More Inflation Ahead?

August 18, 1958

The signs are becoming unmistakable that the recent rise in the stock market is more a reflection of the belief in further inflation (i.e., in a further shrinkage in the dollar) than a reflection of business recovery.

Certainly stock prices are not reflecting current earnings reports. The First National City Bank of New York reports that net profits after taxes of 809 corporations in the first half of this year were 30 percent under those for the corresponding period last year. The automobile industry suffered a 56 percent drop in profits; the railroads, a 61 percent drop.

No one would suspect anything about this by looking at the recent stock market. The Dow-Jones industrial average went up from 420 on Oct. 22 last year to 513 on Aug. 8. This has created some surprising relationships between prices of stocks and the earnings and dividends of the companies. *Barron's*, the financial weekly, has pointed out that the stocks in the Dow-Jones industrial average, as of Aug. 1, were selling at a rate of about 17.3 [times] net earnings. This is higher than any “earnings multiplier” rate in the entire 1949–57 upswing. And *The New York Times* has called attention to some extraordinary examples, such as Universal Cyclops Steel selling at 100 times its current annual earnings rate and Crucible Steel at 110 times.

## STOCK VS. BOND YIELDS

No less significant is the relationship recently established between the dividend yield of stocks and the interest yield of bonds. Normally the yield on common stocks, because of higher risk and uncertainty, is substantially above the yield on high-grade bonds. But as of July 30 the yield on Standard & Poor's index of 500 common stocks was 3.87 percent, or only .13 percentage point above the 3.742 percent yield on its A1+ bond average. This is the closest the two yields have come together since July 1957, when for a short time stocks were actually yielding *less* than A1+ bonds. It was the first time this had happened in more than twenty years.

This situation is usually thought to be paradoxical. In fact, the near-approach of the yields on common shares and bonds is often followed either by a fall in the price of common shares or a rise in the price of bonds. But there is one situation in which the convergence or crossing of stock yields and bond yields is a logical response. This is when investors and speculators *believe that still further monetary inflation is threatened*. In that case stocks are valued abnormally high in relation to current earnings or dividends. Bonds, on the other hand, are valued abnormally low, because the purchasing power of the principal is expected to decline, and lenders insist on a higher interest rate as an "insurance premium" against this.

## EVER-MOUNTING DEBT

If there is a fear of further depreciation of the dollar, the blame rests squarely in Washington. Congress and the Administration, between them, are responsible for the prospect of a \$12 billion deficit in the current fiscal year. Even if we admit that the Federal Reserve authorities either can or should try to "stabilize the economy," they made an extravagant overresponse to a mild recession, slashing the rediscount rate from 3½ to 1¾ percent, reducing required reserves of member banks, and engaging in massive support-buying of government securities. Whatever the immediate effects may be of the restoration of stock-margin requirements from 50 percent to 70 percent, it is unsound and ultimately futile to encourage a *general* inflationary flood and then try to dam off its effects in one or two directions.

And now the Treasury wants a further \$8 billion boost in the national-debt ceiling to \$288 billion. It is time to ask some blunt questions of Congress and the Administration. Do you ever expect the debt to be paid off? Do you ever intend even to *reduce* it? If so, at what rate? Under what conditions? Are the conditions likely to be realized? Do you intend to pay off either principal or interest in dollars of even present (48 cent)

purchasing power, or do you mean to keep short-changing the government's creditors by further depreciation?

President Eisenhower has expressed great concern which, however, must still be translated into policy. ❁

## Rates of Growth

August 25, 1958

Is it true, as we are now so frequently told, that Communist Russia's economic "rate of growth" is faster than ours, or that we cannot survive unless we increase our own "rate of growth"? There are at least five main reasons why rate-of-growth comparisons are untrustworthy.

1—In the midst of daily glib comparisons of national income and particularly "gross national product," or GNP, it may come as a shock to many to learn that these figures are in large part arbitrary. It is impossible to compare the national income of Russia with that of the U.S. We do not know whether the Communists are telling the truth about specific output figures. Even if they were, their figures would have little comparative meaning. They have no true market prices, but only arbitrary government prices and wages. The production of specific goods is not determined by consumer demand. The comparative purchasing power of the inconvertible paper ruble and the U.S. dollar can only be guessed at.

2—It would take a book to describe all the arbitrary judgments and guesses that enter into even our own national income figures. They measure only the values that pass through the market. When a man marries his cook, for example, the money value of her services disappears from the national-income accounts. Inflation constantly changes the value of the dollar in terms of which everything else is measured.

The President's last annual Economic Report boasted in its opening paragraph that the nation's output of goods and services in 1957 totaled \$434 billion, "5 percent larger than in the preceding year." Only later in the report were we explicitly told that "four-fifths of this increase was accounted for by rising prices," and that therefore "in physical terms, the increase was only about 1 percent." This July, however, all national-income estimates were revised again. It seems the government statisticians now think our GNP in 1957 was not \$434 billion but \$440 billion and that our 1956 GNP was not \$415 billion but \$419 billion. Yet in "1957 prices" our 1956 GNP was \$435 billion.

3—It may be thought that we can make meaningful comparisons between the Russian economy and our own in *physical* terms. In certain homogeneous terms,

such as pure metals in ingot form, this may be possible. But in most things there are enormous *qualitative* differences that never get into quantitative statistics. Not how much clothing but what kind of clothing; not how many square feet of housing but what kind of housing; not how much food in bulk but in nutrition, variety, flavor, and quality is what counts for economic welfare. Even in military weapons, quality may be the decisive factor.

4—Prof. G. Warren Nutter has pointed out that there is “a long-run tendency . . . for the industrial growth rates to slow down, or retard, as the level of production gets higher.” There are several basic explanations of this. One has to do with a trick of percentage figures. Another has to do with a physical satiety point in human needs. If only one family in a country has a bathtub, and the next year 50 families get one, the rate of growth is 5,000 percent. But when everybody has a bathtub net growth stops. This principle applies to houses, automobiles, radios, television sets, and so on.

5—Here we come to a more subtle point. Larger crops often have a smaller total dollar value than smaller crops. (Hence crop-restriction schemes.) But this merely illustrates a wider principle. Economists have pointed out since the time of Adam Smith that it is not “value-in-use,” but scarcity, that determines “value-in-exchange,” or money price. Water is an indispensable commodity that ordinarily commands no price at all. If more and more things became plentiful (except dollars), the national income, as measured in dollars, might begin to fall. If we could imagine a situation in which everything we could wish for was in as adequate supply as air and water, we might have no (monetary) national income at all!

Let's stop making a fetish of national income statistics and percentage rates of growth. ❁

## How to Control Credit

September 1, 1958

Within a period of ten days the Federal Reserve authorities illustrated first the wrong and then the right way to control inflation. On Aug. 14 they raised the margin requirements for buying stocks from 50 to 70 percent. On Aug. 14 they permitted the Federal Reserve Bank of San Francisco to raise its discount rate from  $1\frac{3}{4}$  to 2 percent. The first method is what is called “selective” credit control. The second is what is called general credit control. Only the second is equitable and effective.

The targets of selective credit controls are always politically selected. The stock market is the No. 1 target because those with no understanding of its role and function in the American economy regard it as a sort of

glorified gambling casino. As G. Keith Funston, president of the New York Stock Exchange, said in a speech last October:

“I sometimes wonder at our sense of proportion. A man can borrow up to 75 percent to buy a car, 100 percent to buy a washing machine, and 94 percent to buy a house. But he can borrow only 30 percent to buy an interest in the company that makes the car, the washing machine, or the house. We have made it much easier to borrow in order to spend, than to borrow in order to save.”

### THE CREDIT FLOOD

In addition to being discriminatory, these rigid restrictions on stock-buying margins are also in the long run futile. We cannot encourage a *general* inflationary flood and then expect to dam off its effects in one direction. Credit, like water, seeks its level and leaks through every crack. If a man is determined to buy shares, and does not have the required legal margin, he can mortgage his house or other assets and use the proceeds in the stock market.

Raising stock-market margin requirements seldom has the intended effects. No statistics can show, of course, what might have happened to stock-market credit or prices if margins had not been changed. But most margin increases have shown little effect on stock-market credit.

Nor is it easy to justify the latest rise of margin requirements on this ground. As Funston has pointed out, customers' net debit balances on June 30, 1958, totaled \$3.1 billion, which represented only 1.4 percent of the market value of all stocks listed on the New York Stock Exchange on the same date, a ratio almost exactly the same as it was a month earlier or a year before. He might have gone on to point out that it was only half the ratio of 2.8 percent that prevailed in 1955, in the whole period from two to six months after margin requirements had been raised to 70 percent in April.

### RED LIGHT

Increases in margin requirements have sometimes temporarily halted the upward movement of stock prices, but never for more than a month or two. In fact, in every instance of a margin increase from February 1945 through April 1955, stock prices six months later averaged at least 12 percent higher than in the six months before the margin change. That is what we might have expected. The price that people pay for stocks is primarily determined by the expected yield from those stocks and the capitalization of that yield as affected by interest rates.

But because the increases in legal stock margin requirements have not had their *intended* effect, it does



not follow that they have done no harm. Their main effect, careful comparisons show, has been to *reduce the volume of trading*—sometimes as much as 25 percent. This does not merely mean that brokers lose commissions. It reduces the liquidity of the market and throws a damper on the willingness and ability of corporations to raise new money through stock issues.

An increase in the Federal Reserve discount rate is a move in the right direction. Yet it is not the Fed’s bad judgment in forcing the discount rate down to 1¾ percent that is being criticized by the apostles of inflation, but its return toward mild restraint. It is an ominous sign—on both sides—when the majority of standard common stocks sell at a lower yield than long-term government bonds. Some brokers are calling this a “flight from the dollar.” We will disregard this red light at our peril. ❁

A Century of Cycles

September 8, 1958

In a study just issued by the National Bureau of Economic Research, a private organization, Geoffrey H. Moore finds that recent data support earlier indications that the current business contraction may be drawing to a close. Most measures of aggregate economic activity, he finds, have risen above their lows of April or May and personal income has regained its pre-recession level.

These immediate facts are largely known. What I find most interesting in the study is the elaborate comparisons of past business cycles, particularly the comparisons of 24 cycles over a period of a century, from 1854 to 1954. These disprove some hardy myths about business cycles.

Perhaps the hardest of these myths is the belief in the “regularity” of the business cycle. This belief is found, for example, in Keynes’s *General Theory of Employment, Interest and Money*: “There is some recognizable degree of regularity in the time sequence and duration of the upward and downward movements. . . . The duration of the downward movement [has] an order of magnitude which is not fortuitous, which does not fluctuate between, say, one year this time and ten years next time, but which shows some regularity of habit between, let us say, three and five years.”

MEASURING RECESSIONS

Now measuring business cycles is an extremely difficult (and partly arbitrary) task. Different indicators of economic activity have different amplitudes of movement. All reach their relative peaks and troughs at different

times. But the statistical studies of the National Bureau of Economic Research are the most complete and meticulous yet made. And we find from Dr. Moore’s tables that the *average* duration of the downward movement of the 24 cycles in the period from 1854 to 1954 was just twenty months.

But this statistical average conceals a wide range of duration. The contraction beginning in August 1918 lasted only seven months; that beginning in October 1873 lasted 65 months. In spite of Keynes’s impression of regularity, here is a difference in duration of almost ten times as much in one case as in another.

Had Keynes been discussing the average duration of the whole cycle, instead of merely the downward phase, his guess would have come near the mark. The expansion and contraction phase together, of the 24 cycles, add up to just 50 months, or slightly over four years. But this average again conceals wide differences. For whereas the *average* expansion phase of the 24 cycles lasted 30 months, the *range* was from as low as ten months to as long as 80 months.

PRICES VS. WAGE RATES

Statistics by themselves cannot provide either forecasts or remedies. We also need a study of the reasons behind the statistics. Moore points out that with the exception of the 1929 depression, the typical length of the contraction period seems to have shortened since 1920. I suggest that the main reason for this is that since 1933 we have followed an almost continuous policy of inflation. This has restored a workable relationship between costs and prices not by reducing costs but by further raising prices.

But it does not follow that we need the evils of inflation to cure the evils of recession. There is a striking and instructive comparison between 1920 and 1929. Judged by almost any standard, the crisis of 1920–21 was far more severe than the crisis of 1929–30. Here, for example, drawn from Moore’s tables, are the percentage declines in selected indicators in one year in the first period as compared with the second:

	Jan. 1920– Jan. 1921	Aug. 1929– Aug. 1930
Industrial Production	-23	-21
Corporate Profits	-90	-57
Wholesale Prices	-19	-9
Basic Commodity Prices	-39	-17
New Orders (durables)	-53	-36
Residential Construction	-57	-40
Industrial Construction	-77	-46



Why is it, then, that the recovery from 1921 was astonishingly rapid, whereas the depression of 1929 got steadily worse? The chief answer will be found in what happened in the two periods to wage rates. In the first they were still flexible downward as well as upward; they adjusted to lower prices, and allowed a quick recovery. ❀

## 20 Ways to Giveaway

September 15, 1958

Administration policy is difficult to follow. On Aug. 27, President Eisenhower told reporters that he would campaign for a Republican Congress this fall on the issue of "getting down these deficits and keeping our money sound." On the same day he deplored the cut by Congress in foreign-aid spending as "my greatest disappointment." On the day after that, the Administration announced it would participate in a \$350 million aid plan to keep India's grandiose socialistic development program afloat. And on the day before that, in an exchange of letters with Secretary Anderson, the President had urged a still further addition to an expansion of government agencies devoted to pouring U.S. taxpayers' money into foreign countries.

There is already a bewildering maze of agencies for this purpose. There is the World Bank, the International Monetary Fund, the International Finance Corporation, the U.S. Export-Import Bank, the Development Loan Fund, the Agricultural Trade Development and Assistance Act. Now the Secretary and President propose to set up still another agency, an International Development Association, to make "loans" so soft and dubious that even the existing government agencies are forbidden to make them. In addition, larger U.S. Government guarantees are to be made to the World Bank and still more money is to be poured into the International Monetary Fund.

### ALL PILED ON TOP

The proposal to expand the facilities of the Bank and the Fund might have something to be said for it, as a transitional measure, if it were meant to *replace* our foreign-aid program. But there is not the faintest suggestion of such a replacement; all these new schemes are to be piled on top of existing foreign aid. And that foreign aid—which in all forms has already run to more than \$60 billion since the end of the second world war—is presumably to be itself enlarged and perpetuated.

What is the purpose of all this aid? Does experience show that the aid has helped to accomplish its purpose?

The President's letter declares that two of the purposes are to encourage "financial policies that will command the confidence of the public, and assure the strength of currencies" and "to avoid hampering restrictions on the freedom of exchange transactions."

We have now had these institutions and foreign aid for more than a decade. The public never had less confidence in the financial policies of governments. If this were not so, governments could borrow all they really needed from private sources. Inflation is still rampant everywhere. The war that gets the blame ended more than a decade ago. Latin America, where some of the worst inflations are still going on, was relatively untouched by the war. Restrictions on the freedom of exchange transactions were never more widespread. They are all but universal. They are built into the very concept of the International Fund.

### RESCUING SOCIALISM

The truth is that not only have the Fund and foreign aid done nothing to cure this condition; it exists largely *because* of the Fund and foreign aid. If the restrictionist, spendthrift, and socialistic governments of the world did not know that these guardian angels were standing by to rescue them from the results of their own folly, if they knew that there would be nobody to go to but hardheaded private lenders with a prejudice in favor of getting their money back, or of getting solid guarantees, they would long ago have been forced to return to the path of fiscal sanity. In brief, dramatic "rescues" effected by the Fund and our own foreign aid have encouraged the very socialistic planning and fiscal irresponsibility that have made the rescues necessary.

Instead of adding further to our foreign-aid and intergovernment lending institutions, which subsidize foreign socialism, inflation, and exchange control, we should be thinking of how to taper off and terminate such programs; how to stop confusing political with economic goals, and how to return the business of foreign investment to private hands. Not until we have done this will the world get back to stable, hard, and convertible currencies, to private enterprise, and to real economic progress. ❀

## Bipartisan Inflation

September 22, 1958

So far as economic principles are concerned, it grows increasingly difficult to detect any difference between the two major parties. The President has said that he is going to stress "getting down these deficits and keeping

our money sound." A look at the record does show that the Democrats are more openly the party of inflation and massive spending than the Republicans. But it does not show any excessive devotion to economy on the part of the Republicans.

Let us glance back at the economic record of the last session of Congress, and begin with the credits. The list is short. It extended the Reciprocal Trade Act. It alleviated some of the difficulties of the railroads and other taxpayers by repealing the 3 percent tax on freight transportation and the 10 percent tax on passenger fares. Most important of all, as a result of the courage and persistence of Secretary Benson, it reduced the price supports for cotton, rice, and corn, and gave us a less expensive and outrageous farm law.

### **SUPER-SPENDING**

On the debit side the list is much longer. Congress began furiously to "fight the recession," i.e., to start a new round of inflation. It hastily passed a spate of "emergency" spending measures, including \$1.8 billion for Federal housing loans and another \$1.8 billion to speed up Federally aided highway programs. It increased and prolonged unemployment-insurance benefits. It offered a \$500 million Federal loan guaranty program to rescue railroads from the results of excessive Federal regulation. It appropriated another \$3.5 billion for foreign aid. It voted Federal aid (which the President fortunately vetoed) for "depressed areas."

Nobody in Congress had time to keep count. When the session was over, the Tax Foundation, a private research group, announced that a peacetime record of \$83 billion in appropriations and other forms of spending authority had been voted. The Treasury looks forward to a \$12 billion deficit for the current fiscal year. So Congress raised the Federal debt limit to \$228 billion.

The Kennedy-Ives labor bill did not become law, but that was fortunate. The bill contained no effort whatever to deal with the basic sources of union monopoly and coercion. Under the pretense of correcting union abuses it placed more burdens and restrictions on management.

### **SOCIAL INSECURITY**

But if the record of the last session of Congress, and of both political parties, was typified by any one measure, it was the new social-security amendments. For the fourth successive election year, Congress approved a bill to "liberalize" the benefits. It had done this substantially in 1950, 1952, 1954, and 1956. This year's amendments provided another 7 percent general increase. The one thing to be said in extenuation was that Congress did have the candor to provide higher social-security

taxes to pay for the higher benefits. Effective next Jan. 1, employers will each have to pay 2.5 percent in payroll taxes, and the self employed 3.5 percent.

This is a tax on employment. It reduces the current living standards of self-supporting people. It does not increase the supply of goods and services, but places added burdens on production. There is no serious discussion of the long-range costs of this program or the dangers of overexpansion. Once more Peter is robbed to pay—Peter.

Worse, for the fifth time in twelve years, Congress provided for an increase in the Federal share in state public-assistance programs. The President not only signed this bill but hailed it as "a significant forward step." He did object to the successive increases that have raised the Federal share of old-age assistance from 45 percent in 1956 to an estimated 58.5 percent under the new bill. Last January he recommended gradual reduction in the Federal share to 50 percent. But why not, in accordance with the moderate suggestions of the Life Insurance Association of America, and in accordance with a purpose of the original Social Security Act, a gradual but complete elimination of any Federal contribution to state old-age assistance?

As of now, a vote for either party is a vote for more inflation. ❁

## **Inflation by Spending**

September 29, 1958

In its September budget review, the government confirmed that it expects a deficit of more than \$12 billion in the current fiscal year.

This is treated as nobody's fault. It is all blamed impersonally on "the recession." When the current budget was presented in January we were promised a surplus of \$500 million. The present deficit is accounted for by an estimated increase in expenditures of \$5.3 billion to \$79.22 billion, and by an estimated decline in receipts of \$7.4 billion to \$67 billion. One way in which this was restated in some news stories is that 60 percent of the present expected deficit is accounted for by the impact of the recession on receipts and 40 percent by higher spending.

It is possible, however, to apply a different kind of analysis. This would begin by pointing out that the original January estimates were not realistic. This column was not alone in making such comments as the following (on Jan. 27): "It seems highly probable that estimates of both receipts and expenditures for 1950 err on the optimistic side. . . . In an acknowledged

period of declining business, the President wishfully estimates budget receipts from the same taxes at \$2 billion more in 1959 than in 1958. And Democratic leaders (and some Republicans) are demanding even higher spending."

### **BLAMING THE RECESSION**

Can the higher spending be blamed on the recession? Well, unemployment-insurance payments are now expected to be \$585 million higher than expected in January, and expenditures on housing are expected to be more than \$1 billion higher because of the "emergency anti-recession" mortgage-buying program. But it is not the recession or the panicky actions caused by it, but record crops (encouraged by the subsidies themselves) that account for the estimated increase of \$1.8 billion in farm price supports. And the increase of \$591 million in the estimated postal deficit was caused mainly by a retroactive pay increase.

Altogether estimated expenditures have increased over January by \$5.3 billion. The planned expenditures even in January were far too high. The nondefense expenditures then recommended, in fact, reached a new high record of \$28.1 billion (not including the \$2.5 billion for the highway program) compared, say, with \$21.2 billion in 1954. Proposed non-defense expenditures in January were higher for 1959 than for 1957 in practically every major category—for foreign economic aid, veterans' benefits, "welfare," farm subsidies, natural resources, and housing.

Estimated spending under the cash budget (which includes the operations of the government's trust funds for social security and jobless pay) now comes to the staggering total for 1959 of \$94 billion.

### **ARE WE HELPLESS?**

Yet we are told that there is nothing we can do about this, and that we must resign ourselves, not only to a \$12 billion deficit this year, but probably to at least a \$6 billion deficit in the next fiscal year.

The truth is that, if a healthy public opinion made itself felt, and if the will existed in Washington, the nondefense budget could be cut now by an annual rate greater than the estimated \$12 billion deficit, and with all-round advantage. The \$6 billion farm-subsidy program is an economic outrage. Most of the \$4 billion foreign-aid program is demonstrably futile. The \$5 billion of veterans' benefits is shamelessly swollen. All of which has been pointed out before.

But under our present budget system (or lack of system) responsibility for reckless expenditure and inflationary deficits cannot be fixed. Congress and the

President shift the blame to each other. We will never have a responsible budget until we adopt the system that prevails in, say, Great Britain, and is approached in many of our states, under which the legislature cannot make any appropriation not recommended by the Executive, or in which the Executive can at least veto or reduce any item in an appropriation bill beyond his recommendation. This constitutional change, it is true, would not be in itself sufficient to assure fiscal responsibility. But it is highly improbable that such responsibility will ever be secured without it. ❁

## **Balanced Labor Law**

October 6, 1958

The new bargaining victories of the United Automobile Workers, in the face of the heavy unemployment already in their ranks and the fall in sales of American cars, may be attributed to the bargaining skill of Walter Reuther or the bargaining ineptitude of the companies. But a "third force" in the background exercised the determining effect. This is the one-sided labor laws and decisions that give enormous bargaining power to union leaders and bargaining weakness to management. A further recent illustration of the effect of these laws was the order issued by the United Steelworkers of America expelling the "ringleaders" of a rebel faction of "traitors" that polled nearly a quarter-million votes in the union's election last year.

### **FREE EMPLOYEE CHOICE**

It is facts like these that emphasize the irrelevance and futility of measures like the Kennedy-Ives bill, which divert attention from the real labor reforms that need to be made.

One of the few lawyers who do have a sense of the urgency of these reforms, and who combine it with political courage and an understanding of the basic economic as well as legal principles involved, is Prof. Sylvester Petro of the New York University School of Law. In a book and in numerous pamphlets and articles, Petro has emphasized "free employee choice" as the guiding principle of labor legislation. He has supported the Taft-Hartley Act and the state right-to-work laws to the extent that they are built around this principle. But he has criticized the provisions of the Taft-Hartley Act that sanction compulsory-unionism agreements or accept the exclusive-bargaining, majority-rule principle.



In a recent speech before a meeting of the Mont Pelerin Society at Princeton, Petro tried to clarify “free employee choice” further by outlining how a brief law might read. I quote some of his principal suggestions:

“1—Employees shall have the right to join or not to join labor organizations and to participate or to refuse to participate in collective bargaining and other concerted activities.

“2—It shall be unlawful: (a) for any employer or trade union by picketing or otherwise to coercively restrain employees in the exercise of the rights stated in Section 1 . . . and provided further that no party subject to this act shall be required to meet, treat, or bargain with any other party or person subject to this act; (b) for any party or person subject to this act to condition employment or to cause or to attempt to cause the conditioning of employment upon membership or nonmembership in any labor organization; (c) for any employer to induce or encourage any other employer or any other person to visit reprisals upon any employee for his exercise of the rights stated in Section 1; (d) for any trade union to induce or encourage any other trade union or any other person to cease or interrupt any economic relationship. . . . *Provided* that nothing in this act shall prohibit employees during a dispute with their own employer over their own wages, hours, or other conditions of employment from leaving their employment in an orderly way and to go on strike. . . .”

I have omitted several provisions because of the requirements of space. In addition, Petro would add a third set of provisions abolishing the National Labor Relations Board, repealing the National Labor Relations Act and all laws restricting the jurisdiction of the courts in labor disputes and giving full jurisdiction at law and in equity to any court, state or Federal, having jurisdiction over the parties to any case arising.

### STOP UNION VIOLENCE

Petro has performed a service in trying to formulate a specific labor law to embody his central principle of free employee choice. By doing so he has helped to point up the one-sidedness of our existing labor laws drawn in the interests of maintaining union-boss power rather than in the interest of the individual worker, employer, or consumer. His accompanying discussion has brought out the unreality of present labor law that ignores the central problem of trade-union violence. The rule of law means rules that apply equally to all persons, not rules framed to favor on group at the expense of another. ⚙

## Interest-Rate Tides

October 13, 1958

It was the contention of John Maynard Keynes, still accepted by many academic economists, that interest rates are a purely monetary phenomenon. In his own words: “The rate of interest is the reward for parting with liquidity for a specified period . . . a measure of the unwillingness of those who possess money to part with their liquid control over it.”

This theory not only ignores or contradicts most of what has been written by economists for the last two centuries, but is clearly contrary to the facts it presumes to explain. If Keynes’s theory were right, short-term interest rates would be highest precisely at the bottom of a depression, to overcome the individual’s reluctance to part with cash then. But it is in a depression that short-term interest rates tend to be lowest. If the “liquidity-preference” theory were right, short-term interest rates would be lowest at the peak of a boom, because confidence would be highest then, and everybody would be wishing to invest in projects and “things” rather than in money. But it is at the peak of a boom that short-term interest rates tend to be highest.

It is not easy to prove this relationship statistically, partly because so many influences govern interest rates, and partly because there is no “pure” index of “depression” and “prosperity.” But Geoffrey H. Moore, associate director of research of the National Bureau of Economic Research, who has done much work along this line, has at my request kindly furnished the data, and H. Irving Forman of the same organization has prepared the accompanying chart, comparing the Federal Reserve index of industrial production with bank rates on short-term business loans in the ten-year period running from 1948 through part of 1958.

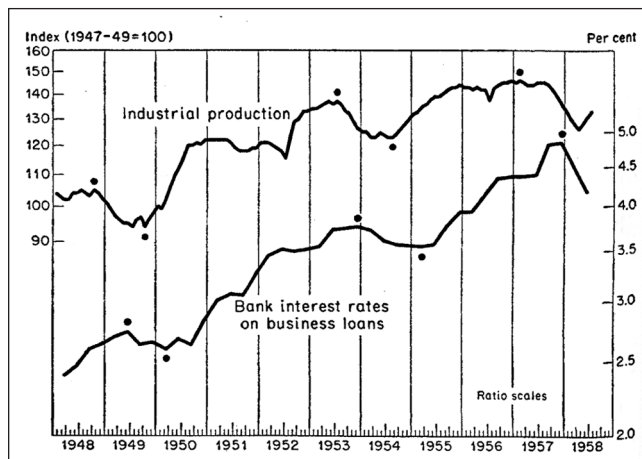
The industrial production scale on the left and the interest-rate scale on the right are ratio scales, in order to bring out more clearly the proportional changes in the two indexes.

### MONEY-RATE AND OUTPUT

The results show that the two indexes tend to go up or down together. Or, more strictly speaking, the industrial production index leads, and the interest-rate index lags. This is what we might expect. When production has been low, demand for loans is low and interest rates are low. As production increases, the demand for loans to expand production increases, and if the money and credit supply is not too “elastic,” interest rates tend to rise, but with a time lag. There is also a reciprocal and inverse influence of interest rates on production. Low interest rates tend to encourage borrowing



for subsequent production, and high interest rates to discourage borrowing for subsequent production. ☼



## Why Don't We Join?

October 20, 1958

LONDON—The first thing that impresses the traveler who makes infrequent visits to a country is the change in the physical appearance. London in 1947 was still in large part a scene of ruins. By 1951 incredibly little progress had been made. Today, though there are still here and there jagged brick walls and unfilled excavations, the restoration, with many modern office buildings and new housing developments, seems almost complete. The improvement in the dress of the people, since 1947, is dramatic. The shops present a similar contrast—but the prices seem incredibly high, and comparing them with British wage statistics, one wonders where the purchasing power comes from.

The physical change in England is, of course, confirmed in the national income statistics, in the improvement in dollar and gold reserves, and in the strength of the pound sterling. Transferable nonresident sterling has reached practically complete convertibility. One of the most remarkable developments of the postwar period, in retrospect, has been the way in which the British have been able to maintain the pound sterling as the dominant currency of international trade, though it is tied, not to gold, but to the dollar. The tail, so to speak, has triumphed over the kite. The explanation is complex; but part of it is the superiority of British banking brains and British financial know-how.

### COUNTERPROPOSALS

A chief topic of discussion here is the new common market and the British counterproposals for a free-trade area. The common market (or European

Economic Community, EEC) is now, at least on paper, a fact. Under the Treaty of Rome the six countries of Belgium, France, Germany, Italy, the Netherlands, and Luxembourg have established a customs union which is to reduce and finally abolish tariffs among the six over a period of twelve to fifteen years, and maintain a common tariff, equal to the present average tariffs of the six, against all non-member countries.

The British, partly because of their ties with the other countries of the Commonwealth, and partly because of the political nature of the proposed common market, have refused to join but have proposed, as an alternative, that Britain, the six, and ten other countries, now members of the OEEC (Organization for European Economic Cooperation), form a free-trade area that would reduce and abolish tariffs among the seventeen members over a fifteen-year period, but would allow each to retain its own tariff schedule against non-member countries.

Reginald Maudling, who heads the committee negotiating for Britain, has objected to the proposed common market of the six on the ground that British goods would have to pay a higher rate of duty in the Dutch market, say, than German goods. He regards this as "discrimination." He has expressed the fear that the six countries may pursue "inward-looking" or "trade diverting" policies rather than "outward-looking" or "trade creating" policies—in other words, they may concentrate more on expanding trade among themselves than on maintaining imports from "traditional suppliers."

### DOUBLE STANDARD

All these objections seem thoroughly justified. But if they seem valid for the British, they seem equally valid for ourselves. Why have American officials encouraged a common market from which the U.S. is to be excluded? Why, for that matter, are they encouraging a free-trade area from which the U.S. would be excluded? One can understand how they might take the position that it is no business of ours either way—unless discrimination against American goods turned out to be more serious, on net balance, after the EEC or the FTA became actualities. But it is a strange double standard of economic theory or economic morality for our officials to give their direct encouragement to a common market or a free-trade area for other countries, on the ground that freer trade among them is the best economic medicine, while we ourselves refuse to have anything to do with it, preferring to maintain protection, high tariffs, quotas on imports, and export subsidies, and dumping as a result of our farm price support program, and

even accept discrimination against American exports in order to go it alone with our protectionism. ❁

## French Revival

October 27, 1958

PARIS—The overwhelming popular endorsement of the new Constitution, which meant the overwhelming popular endorsement of the leadership of de Gaulle, has given a great lift to the French spirit and to French hopes. This increased confidence is, of course, primarily political and military. If de Gaulle is able to unify France, if he is able to bring peace in Algeria, if he is able to make France once more a bastion of NATO, the whole outlook for the West will become brighter.

This surge of confidence has had its immediate economic effect in encouraging a return of capital to France. It improves the long-term economic outlook. But the immediate problems are still grave, and above all the problems of the budget and of inflation. The officially estimated deficit for the present calendar year is 600 billion francs (about \$1.4 billion), but most observers think it will run higher. And the budget for 1959, though it has not yet been presented, is widely expected to run to still larger expenditures and a still larger deficit. This is because increased authorizations have been voted or promised in the past. De Gaulle himself has promised increased spending for his Algerian development program.

### MOUNTAIN OF SUBSIDIES

Among those who are concerned by this situation, however, there is widespread hope that de Gaulle and Finance Minister Pinay may make a thorough re-examination of the budget to find economies that will offset the promised new expenditures in Algeria. These economies, of course, will be tremendously difficult politically. For what unbalances the French budget is truly a mountain of welfare programs and subsidies—for “investment,” for social security, for the railroads, for coal, for wheat, for gasoline, for milk, for beet sugar, for chocolate.

Moreover, some authorities who have analyzed the French inflation point out that even the budget deficit, great as it is, has not been the chief cause of the inflation of the last six years. They blame the policy of the Bank of France. Between December of 1952 and September of this year, for example, the bank’s advances to the government increased by 464 billion francs. But the bank’s extension of “medium-term” credits increased by 1,004 billion francs. In other words, only about a third

of the inflation (i.e., of the resulting increase in the money supply) was the consequence of the budget deficit, whereas about two-thirds came from the increase in medium-term credits. These credits are chiefly for housing; others are for the purchase of machinery by French industry. They are actually twenty-year loans; but they are called medium-term (*moyen terme*) because the government has agreed to take them off the bank’s hands at the end of five years.

### TIGHTENED CREDIT

Critics of this policy contend that it is a gross violation of all central bank principles to discount loans running for twenty or even for five years. They argue that it is absurd to discount three-month bills at 5 percent, and to discount twenty-year paper at an effective rate of only 4 percent.

In the last year or so credit has been considerably tightened, but through quantitative controls rather than through a flat increase of the discount rate. Ceilings are now placed both on the borrowing of each commercial bank from the Bank of France and on the loans that the commercial banks may make. There are a series of such ceilings. The first amounts to 65 percent of the ceiling on a bank’s borrowings as of July 1, 1957. On such borrowings the commercial bank paid a 5 percent (now reduced to 4½ percent) discount rate. On any borrowing above this of 10 percent or less it paid in addition a penalty rate of 2 percent. If it broke through this second ceiling it paid a penalty rate of 4 percent up to a third ceiling.

These quantitative controls and penalty rates have slowed down the inflation considerably. But they take nearly all the flexibility out of the money market. They favor established borrowers at the cost of new enterprises. They lead to an uneconomic allocation of credit and production.

But the new government seems more determined than its predecessors to make courageous reforms. ❁

## Why Do We Apologize?

November 3, 1958

BRUSSELS—Now that the Brussels World’s Fair has closed, we may take stock of the American exhibit. On net balance it must be set down as a missed opportunity.

Our exhibit had, of course, virtues as well as faults. The American pavilion, from the outside, was a circle of golden beauty, especially at night. And some individual exhibits, like the Circarama, were first-rate, and made one proud to be an American. But that exhibit

was made possible by a grant from the Ford Motor Co. Fund.

There were two rational objectives for an American exhibit, one narrow, one broad. The narrower objective would have been to show foreign visitors the range and quality of goods that America has to sell to the world. This would have helped to increase American exports, as well as impressed foreigners with American economic strength, versatility, and skill. This task was hardly even attempted. The only automobile shown was a 1903 Ford. The few industrial exhibits of, say, model kitchens, office machines, TV, radio, etc., were scattered and haphazard, inferior to what one might find in a typical New York showroom. In fact, the American exhibit was notable for wasted space. All this contrasted sharply with the magnificent exhibit put on by the Federation of British Industries.

### PEOPLE'S CAPITALISM

The wider objective of our exhibit might have been to display the merits of the American free-enterprise system. It would not have been to show how well off we were, but how we got to be that well off, and how other nations, by following the same policies, instead of the economic dead-end street of statism, socialism, or Communism, could achieve a like result. It would have been to show, in other words, how "people's capitalism" had provided the American masses with comforts and amenities that a king could not enjoy a century ago.

It would be unfair to say that this objective was entirely neglected. The visitor who went through the American exhibit very carefully could have found small signs telling him that one of the great secrets of American productivity was that American industry had invested an average of \$14,500 per worker to provide the tools and machinery responsible for this enormous productivity.

But none of this was dramatized or pictured. The signs were so small that one wonders whether one in a hundred visitors noticed them. On the other hand, great space was devoted to apologies. There were immense black-and-white pictures of New York and Chicago that seemed deliberately intended to emphasize drabness and ugliness. In accompanying signs visitors were told that Manhattan's buildings are "generally without rhythm in the artless gridiron," that they "have shot up without reference to any overall scheme—merely in answer to the law of supply and demand, tempered by the owner's judgment."

### 'PLANNING' BIAS

Much else reflected this "planning" and anti-free-market bias. The point is not whether such criticisms were warranted, but whether they had any place in an

exhibit the primary purpose of which should have been to give the best, not the worst, impression of America. No other nation whose pavilion I visited seemed to have thought it necessary to exhibit its slums and its sore spots, or to make any apology for its shortcomings.

The model for what we should have done was of course not the Russian exhibit, with its display of ruthless power, its obsession with gigantic machines, its blatant propaganda and lies (there were cars on exhibit which the well-informed say will not be in production until 1962), but the British exhibit, which, with a much smaller budget than ours, turned in a thoroughly first-rate job. Ironically, the one photograph at the fair that showed lower Manhattan as a thing of beauty was a large colored transparency at the British exhibit advertising BOAC.

Somehow the United States exhibit at the fair seemed to symbolize an attitude of national apology and *mea-culpism* that has grown up in our officialdom in recent years in our relations with foreign countries. We are afraid to call attention even to our real virtues for fear that foreigners will think us boastful or will feel offended. ☸

## Ten-Year Miracle

November 10, 1958

BONN—The economic history of present-day Germany begins on a single day—June 21, 1948. This was the day of what is usually described as "the currency reform." On that day two things happened—the old currency was abolished and a new currency substituted; and price controls (with the exception of rent controls) were abolished overnight. The very next business day, goods appeared in the shops, and enterprise began to spurt forward.

In most discussion, both in Germany and the outside world, it is "the currency reform," rather than the abolition of price control, that gets the chief credit for the resulting economic "miracle." But an analysis of the facts does not seem to support this conclusion. It is said that the old currency had become "worthless"—but it was "worthless" only because nobody would sell anything at the ridiculously unrealistic controlled prices. It was this that drove the Germans into a primitive barter economy. This is not to belittle the importance of the currency reform, with its insurance of a relatively stable value; but, as France and Italy have proved, with relative freedom from absurd price controls, a nation's economy can function even after a huge inflation and



with a currency unit with a value of a fraction of an American cent.

### INCREDIBLE PROGRESS

After ten years the German economic miracle continues, and the most impressive evidence is in the incredible amount and quality of new building. Practically all the leading cities suffered terrific destruction in the second world war, ranging from 60 to 90 percent. Taking the country as a whole, it is estimated that before the war the number of dwelling houses (or dwelling "units") was 11.5 million. Of these about 2,250,000 were totally destroyed and 2.5 million so damaged as to become uninhabitable, making a total effective destruction of some 4,750,000. The proportional damage to office buildings and factories was presumably much worse, because of the concentration of bombing in the center of big industrial cities. Yet one can stand at many points of Bonn, Cologne, Düsseldorf, and Frankfurt and see nothing but new buildings, nearly all looking modern, substantial, even luxurious. Since 1950 Germany has built new dwelling units at an annual rate of 540,000. If this rate is continued, the housing target of the government will be achieved by 1962 or 1963.

The Germans themselves attribute their economic miracle, in the recent words of Karl Blessing, president of the Bundesbank (Germany's central bank), to their trust "in a free-market economy and in private initiative." And this explanation is correct. But it is necessary to add that the German economy, like the Swiss, is only relatively, not absolutely, a free-market and private-initiative economy.

### PERSISTENT PROBLEM

Take housing, for example. A large percentage of it, renting for certain maximum rents, has been built with the help of state subsidies. Like all subsidized housing, in England, France, or at home, it can usually be quickly recognized by its regimented or barracks-like quality. For new non-subsidized housing or office buildings, there is no rent control, but rent control is still kept on old housing, which explains why it is so seldom renovated or adequately repaired.

In spite of the incredible economic renaissance of Germany, and its success in maintaining, with Switzerland, one of the two hardest currencies in Europe, it has not wholly escaped from the problems and dangers of inflation. Since 1951 the consumer price index has risen from 108 to 119, though it has been steady since January. The inflationary pressure comes from three sources. Wages, particularly in the building industry, have been pushing upward. The favorable balance of trade has led to the domestic money supply increasing more than the domestic supply of goods.

And there are heavy and increasing drains on the budget. As one example, social-security payments now go up automatically with a rising wage index.

The political problem of inflation in Germany, in short, is not unlike that in the United States; and our present election results are likely to make our own inflationary pressures greater rather than less. ⚙

## That 'Common Market'

November 17, 1958

ROME—The clash between the British and French over the proposed free-trade area for seventeen countries versus the common market for six has underlined the fact that the difference between the two is not merely technical but one of basic concept. The free-trade area contemplates a mutual lowering of tariffs among seventeen European nations over a period of fifteen years, with each nation free to set its own tariffs against nonmember countries. The common market plans a mutual lowering and final abolition of tariff barriers among six nations (France, Germany, Belgium, the Netherlands, Luxembourg, Italy) over twelve to fifteen years, but insists these countries must maintain a common tariff, equal to the present average tariffs of the six, against all nonmember countries.

Each plan has its difficulties. The French point out that in the proposed free-trade area exporters of non-member countries could ship their goods to whichever of the seventeen countries had the lowest tariff for their particular products, and that it might be extremely difficult to prevent transshipment free of duty to other countries within the free-trade area. The French seem to have little faith in the British schemes for certificates of origin, compensating duties, and so on. On the other hand, when the two projects are compared, it becomes increasingly clear that the British proposal for a free-trade area would really tend toward freer world trade, whereas the French-inspired common market might tend toward a perpetuation of protectionism, discrimination, planned economies, and inflationary pressures.

### WORKABLE? DESIRABLE?

There are two main questions to be asked about the common market. Would it work as planned? And, assuming that it would work, would it be desirable?

When we consider the first question, we are confronted by a problem that is being treated very lightly and casually but which is central and crucial. This concerns the soundness and stability of each national currency. If any nation of the six has more inflation than



another, if the real value of its currency falls with relation to the others, it is obvious that the common market will break down. Unless there is complete convertibility of each currency into the others, the common market is merely a name. But if there is such convertibility, and if one currency, say the French franc, is overvalued in the official rates of exchange, then France will develop a chronic deficit in its balance of payments, and the other countries will not be willing to extend it credit indefinitely for the purpose of subsidizing its internal inflation.

Even if we assume that this problem can be successfully surmounted, however, we must ask whether the common market would be desirable. And in regard to this question there have been rising doubts, not only among officials in countries outside the proposed common market, but among thoughtful persons within the common-market countries, and among genuinely liberal economists.

THE DANGER

Outstanding among the critics, for example, is the German-Swiss economist Wilhelm Röpke. Röpke points out that if each country concerned were willing to return to an internal free market economy and monetary discipline, and to lower tariffs of its own free will, for the benefit of its own consumers, there would be no need of a formal common market. On the other hand, if any one of the member countries fails to accept a market economy and monetary discipline the common market cannot function. The common market will not relieve any member country of the necessity of re-establishing free convertibility for its money.

Yet there is great danger that the countries in which inflationary pressures, the welfare state, a planned economy, and a philosophy of “full employment at any price” have gone farthest will push the other member countries in the same direction in order to “harmonize” production costs by raising rather than lowering them. And the greatest danger is that the common market, instead of “integrating” Europe, may disintegrate it by breaking it into rival blocs discriminating against each other. ⚙

Why Cheap Money Fails

November 24, 1958

The late Lord Keynes preached two great remedies for unemployment. One was deficit financing. The other was artificially cheap money brought about by central bank policy. Both alleged remedies have since been assiduously pursued by nearly all governments, and are still being assiduously pursued by our own. The result

has been worldwide inflation and a constantly shrinking purchasing power of monetary units. But the success in curing unemployment has been much more doubtful.

In *Newsweek* April 28 I published a table comparing the deficits and unemployment for the ten years from 1931 through 1940. The average annual deficit in this ten-year period was \$2.8 billion (equivalent to nearly \$16 billion today as a comparable percentage of national income), yet unemployment then averaged nearly 10 million, or 18.6 percent of the total working force.

Does cheap money have any better record as a cure for unemployment? Here is a table covering the twelve years from 1929 through 1940 inclusive, comparing the average annual rate of prime commercial paper maturing in four to six months with the percentage of unemployment in the same year. Both sets of figures are from official sources.

Year	Commercial Paper Rate	Percentage of Unemployment
1929	5.85%	3.2%
1930	3.59	8.7
1931	2.64	15.9
1932	2.73	23.6
1933	1.73	24.9
1934	1.02	21.7
1935	.75	20.1
1936	.75	16.9
1937	.94	14.3
1938	.81	19.0
1939	.59	17.2
1940	.56	14.6

In sum, over this period of a dozen years low interest rates did not eliminate unemployment. On the contrary, unemployment actually increased in years when interest rates went down. Even in the seven-year period from 1934 through 1940, when the cheap-money policy was pushed to an average infra-low rate below 1 percent (.77 of 1 percent), an average of more than seventeen in every hundred persons in the labor force were unemployed.

Let us skip over the war years when war demands, massive deficits, and massive inflation combined to bring overemployment, and take up the record again for the last ten years:

Year	Commercial Paper Rate	Percentage of Unemployment
1949	1.49%	5.5%
1950	1.45	5.0
1951	2.16	3.0
1952	2.33	2.7
1953	2.52	2.5
1954	1.58	5.0
1955	2.18	4.0
1956	3.31	3.8
1957	3.81	*4.3
1958 (July)	1.50	*7.3

It will be noticed that though the commercial paper interest rate in this period averaged 2.23 percent, or three times as high as that in the seven years from 1934 through 1940, the rate of unemployment was not higher, but much lower, averaging only 4.3 percent compared with 17.7 percent in the 1934–40 period.

And within this second period itself the relationship of unemployment to interest rates is almost the exact opposite of that suggested by Keynesian theory. In 1949, 1950, 1954, and July of 1958, when the commercial paper interest rate averaged about 1½ percent, unemployment averaged 5 percent and over. In 1956 and 1957, when commercial paper rates were at their highest average level of the period at 3.56 percent, unemployment averaged only 4 percent of the working force.

In brief, neither deficit spending nor cheap-money policies are enough by themselves to eliminate even prolonged mass unemployment, let alone to prevent unemployment altogether.

The only real cure for unemployment is precisely the one that the Keynesians and inflationists reject—the adjustment of wage rates to the marginal labor productivity or “equilibrium” level—the balance and coordination of wages and prices. When wage rates are in equilibrium with prices, there will tend to be full employment regardless of whether interest rates are “high” or “low.” But regardless of how low interest rates are pushed, there will be unemployment if wage rates are too high to permit workable profit margins.

\*Unemployment percentages before 1957 are based on Department of Commerce “old definitions” of unemployment; for 1957 and 1958 they are based on the “new definitions,” which make unemployment slightly higher—4.2 percent of the labor force in 1956, for example, instead of the 3.8 percent in the table. ❁

## In Franco's Spain

December 1, 1958

MADRID—Spain today has one foot in the present age, the other in the past. It is trying to jump without intermediate steps from the candle to the fluorescent light, from the burro to the Buick. One drives out of a beautiful, expanding modern Madrid to villages where people live much as they did centuries ago. In comparison with all other Western European countries (except Portugal), the Spanish people still have an extremely low standard of living. As one editor put it to me: “We have an Arab economy—without the oil.”

If Germany is the most dramatic example in Western Europe of the miracles of recovery and production that can be brought about by monetary discipline and a free economy, Spain is the outstanding demonstration of how an economy can be unbalanced and shackled by socialism, government planning, and a tangle of interventions and controls.

Take the situation in automobiles. Unless you are a diplomat or have special governmental pull, it is practically impossible to import a foreign car. In fact, the hardest thing to get in Spain seems to be an import license for almost anything at all. Major auto companies are directly or indirectly government-owned or government-operated.

### HOW TO GET A CAR

If you want a SEAT (licensed by Italy's Fiat), you must first file an application accompanied by \$400 (translating pesetas into dollars at 50 to 1). A year or so later you may be notified that your car is ready. You must then pay, before delivery, 100 percent of the price of the car—say \$2,800. A month or two later you may get actual delivery. But if you sell the car on the black market you may get almost double what you paid for it. At present, I am told, there are 22,000 signed orders for SEAT's, each accompanied by \$400, yet the total production of SEAT's this year will be only 10,000 and 12,000 next year.

American industrialists here tell me that they could sell 20,000 farm tractors over the telephone if they could get the import licenses. But the government insists that the farmers can wait until domestic industrial production is adequate to take care of their needs. All this, of course, slows down both Spanish agricultural and industrial growth.

Special permission must be obtained not merely to go into a new business, but to manufacture a prescribed maximum of a specific thing. Thus in September a number of firms were finally authorized to make television sets. The Spanish Marconi Co. was allowed to

make 5,000; the Standard Electric, 5,000; the Spanish RCA, 3,500 sets, etc.

### WHY IT FUNCTIONS

There is extensive price fixing and completely unrealistic rent control. As a result there are periodic shortages of, for example, oil, eggs, potatoes. Most new apartments are not rented but sold. There are periodic power shortages in Madrid, and the electricity is rationed or turned off. There has been great inflation. Between 1950 and 1957 the wholesale price index advanced 84 percent. Between July 1957 and July of this year the official cost-of-living index jumped 13 percent. The official rate for the peseta is 42 to the dollar, but the free-market rate in Tangier has been between 58 and 60.

What is amazing is how such an economy functions at all. And yet it does, and in some directions shows surprising growth. One reason seems to be that many of the controls that exist on paper are evaded or laxly enforced. It is widely admitted that the Spanish economy has been saved from grinding to a halt by the smugglers and the black marketeers.

The other main reason for Spain's recent economic progress is that Franco has brought and kept domestic peace and order. All criticism of his economic policy (voluble in private conversation, but prohibited in the press) is tempered by the feeling that Franco is still the only alternative in Spain to the nightmare of Communist rule. Peace and order have enabled people to work, and the workers work hard for incredibly long hours. But Spanish recovery would jump forward dramatically if Franco could be brought to see that while a rich country does not need socialism, monopolies, and controls, a poor country cannot afford them. ☸

## Our Policy in Europe

December 8, 1958

A visit to seven European countries in a total of eight weeks is apt to produce kaleidoscopic impressions, but one or two stand out clearly. The first is a striking growth in prosperity compared with ten or even five years ago. Everywhere people are better dressed. Almost everywhere there is an astonishing amount of new building. This is most impressive in West Germany; but almost as remarkable is the new building in Belgium and in the northern half of Italy.

This new building has gone on in spite of—and even partly because of—rent control. All seven countries (except Belgium) have retained some sort of rent control. This usually takes the form of rent control on

old houses and freedom from it on new ones. The result is increasing disrepair in old housing but some incentive to new housing, to which is commonly added the incentive of direct or indirect state subsidies. Where, because of the extent of inflation, rent control is most out of line with realities, as in France, the dilapidation of old housing and comparative lack of new housing is most noticeable.

### BRANDS OF SOCIALISM

What stands out is not the differences in the economic policies of the various countries of Europe but the similarities. This applies even to Spain, which is under a dictatorship and still seems in large part cut off from the rest of Europe. Though all of Europe has been moving in the last five or ten years toward a relaxation of controls, most European economies are still marked by a continuation of socialism, protectionism, deficits, and inflation. While European “democratic” leftists have for twenty years been denouncing the “reactionary,” “dictatorial,” and “Fascistic” policies of Franco, it is hard, economically, to distinguish between their policies and his.

It is not easy to describe the difference, for example, between Italy's Socialism of the left and Franco's Socialism of the right. The Italian Government, through its holding company, Istituto per la Ricostruzione Industriale, popularly known as IRI (pronounced Erie), controls or owns stock in most large Italian industrial companies. The Spanish Government owns or controls large industries through a similar agency, Instituto Nacional de Industria, the INI. Both organizations came into existence because of an alleged emergency, but neither government seems in any haste to sell its securities back to private hands. If Italian industry has forged ahead faster than Spanish it is partly because IRI makes more effort to emulate the principles of private enterprise than INI, and partly because Italy does not put the appalling obstacles in the way of new private industry that Spain does.

### WHAT WE COULD DO

Yet what is most puzzling in Europe is American policy. Why, for example, do we give our actual support and blessing to the proposed six-nation “common market”? This would discriminate against American goods, make it more difficult on net balance for American exporters to sell to the countries involved, divide Europe into rival trade blocs, and tend to increase, and perpetuate bureaucratic controls and protection rather than to move toward free trade. Why do we in Spain (or anywhere else) pour in American aid that obviously goes to subsidize foreign socialism and to prolong government



controls, which in turn retard rather than promote economic growth and freedom?

There are two main things that we could do, in the economic sphere, for Europe and the rest of the world. The first would be to keep the dollar strong and beyond suspicion, a hitching post and a model for other currencies until they are restored to soundness. The second would be to open our markets to European goods, to encourage European industrial growth through the self-supporting and self-respecting method of trade, not aid. We are doing neither. At home we are pursuing policies of inflation, undermining the integrity of the dollar. In trade we are moving toward more protectionism, exclusionism, and quota systems. Abroad we are subsidizing, at the expense of the American taxpayer, exchange control, socialism, and inflation. Our so-called "foreign economic policy" is in need of thorough reform. ❁

## Defense Will Not Win

December 15, 1958

During the second world war there appeared a book called *Defense Will Not Win the War*, by W.F. Kernan. Its chief importance lay in the title, which stated a self-evident truth. No war is ever won by defense alone.

This applies also to a so-called cold war. We are in the present cold war whether we want to be or not; it is being persistently and relentlessly waged against us. And if we lose it, through appeasement, retreat, or by trying to pretend that it is not going on, we shall surely lose the total war if it comes or be forced to surrender before the mere threat of such a war.

The present Berlin crisis is "new," and yet depressingly familiar. We accepted an arrangement in 1945 that enables Russia to put the squeeze on Berlin at any time it sees an advantage in doing so. It did so in 1948. Why were we taken by surprise by the new threats? Why did we act as if we were improvising an answer to a totally unexpected move? Why, above all, was our answer (until recently) merely defensive, and in at least one statement by Secretary Dulles, even ambiguous?

If we had warned Russia immediately that we meant to stand by our obligation to defend and maintain the status of Berlin against any breach by threat or force; if we had replied at the very beginning that we would be willing to discuss a peaceful change in the status quo in Germany but proposed that this should consist in a free and unintimidated vote of the East Germans as to whether they wanted to reunite with West Germany, much needless anxiety might have been saved.

## ANSWER EVERY LIE

We might even have used the occasion to suggest that Russia keep her treaty agreements to allow free and secret elections in Poland, Rumania, Hungary, and Bulgaria for governments of their own choice. If Russia were shown that her diplomatic and propaganda offensives might boomerang, she might be less quick to try them.

This need to take the offensive in the cold war, for our own ultimate peace and safety, was emphasized by George F. Kennan in a lecture last year. Speaking of the way in which we often dismiss Soviet lies as "just propaganda," he said:

"I'm always startled at the phrase 'just propaganda.' Why just? Is not propaganda a serious and important force in world affairs? . . . A wise Western policy will insist 'no single falsehood or distortion from the Soviet side should ever go unanswered.' This will be tiresome. We do not like repetition. But we cannot afford to dispense with it. Truth does not win over error on its merits. It, too, has to be assiduously propagated.

"I have asserted that there is nothing that could be said to Soviet leaders in the space of a few days that would change their strangely corrupted mentality. But there are things which could be said every day over the course of years which would exert a useful discipline upon them, would make it harder for them to ignore the distinction between the real and the unreal, and would place limitations on their use of falsehood as a weapon of political policy."

## ABSURD OUTPUT CLAIMS

To apply this to the particular purview of this column, in recent months a flood of nonsense has been pouring almost unanswered through the American press and through scores of speeches in which increasingly absurd claims of Communist Russia and Communist China regarding not merely military, but overall civilian production, are solemnly accepted as fact. The effect of this nonsense is to condition people to assume that the terror, force, and regimentation of Communism can increase production and even living standards faster than the freedom in choice of jobs and the free consumer choice of capitalism. Many officials of our own government seem to accept these claims at face value. Their real duty is to check the evidence, or lack of evidence, for every such claim, whenever made, and constantly present the enormous counterevidence. It is important to determine the truth about Russian military production. It is no less important not to be taken in by the brazen propaganda about production miracles and soaring living standards in Russia or Communist China. ❁



## Why We Lose Gold

December 22, 1958

The recent concern about our loss of gold cannot be dismissed as unwarranted. Between Feb. 19 and Dec. 10, 1958, the United States gold stock declined by \$2.2 billion, a drop already exceeding that for any previous year.

This country, it is true, still holds \$20.6 billion, more than one-half of the free world's monetary gold. Yet behind the recent rate of gold loss is a situation that is more serious. Of our gold reserves of \$20 billion on Dec. 3, \$11.7 billion was required as the 25 percent legal cover for Federal Reserve note and deposit liabilities. This left "free" gold reserves of only \$8.3 billion. And United States short-term liabilities to foreign countries on official as well as private account amounted in August 1958 to \$14.2 billion.

The United States, in other words, owes foreigners more in dollars than it holds in excess gold reserves. If these foreigners elected to withdraw all their liquid dollar assets in the form of gold, they would more than wipe out the "free" gold we now have. It is also worth keeping in mind that if Congress had not reduced the gold-reserve requirements in 1945 to only 25 percent, instead of the previous 35 percent against deposits and 40 percent against notes, the amount of "free" gold today would be only \$2.2 billion.

### TO RESTORE TRUST

The probability that foreigners would actually seek to withdraw all their dollar balances in the form of gold is at the moment low. They can do so only through their central banks. They prefer, moreover, to keep a certain amount of dollar balances here because they earn interest, and because they are needed for working capital. In addition, foreigners owe American creditors dollars on long-term account.

But we cannot remain complacent about the situation. As the First National City Bank of New York points out in a sober discussion:

"A flight from the dollar—not only by foreigners but by Americans as well—might well be touched off if the idea gained ground that conditions were developing under which a rise in gold price would appear inevitable. Because of the strategic importance of the United States and the dollar, foreign bankers, businessmen, and investors are—understandably—watching how we handle our monetary and fiscal affairs. What counts is the determination of the United States Government and of the Federal Reserve System to safeguard economic and monetary stability and thus prevent—by deeds, and not by words alone—spread of doubts concerning the

assured maintenance of dollar stability. The fact that excess gold reserves are still so far above minimum requirements gives time—but not indefinite time—to repair policies that hurt trust in the dollar."

### FIVE POSSIBLE STEPS

Here are some of the specific steps we might consider to keep or restore confidence in the dollar:

1—Let the Federal Reserve definitely abandon cheap-money policies. Moderately firm interest rates will not only discourage the withdrawal of foreign balances but will stop encouragement to credit expansion.

2—Congress could show its own determination to protect the integrity of the dollar either by restoring the pre-1945 Federal Reserve gold-cover requirements or by otherwise limiting further credit expansion.

3—The situation plainly calls for a drastic reduction in foreign aid. It is absurd to increase inflation here, and to undermine our own currency unit, by giving away more dollars to countries that already have deposits or short-term claims here in excess of our free gold supply.

4—We must immediately put our own fiscal house in order, drastically reduce our prospective \$12 billion deficit in the current fiscal year, and try to eliminate any deficit in the next fiscal year. This could be accomplished by drastic cuts in foreign aid, in farm subsidies and price supports, and in a score of other directions.

5—Revise the Federal laws that put grossly excessive bargaining power in the hands of union leaders, make it all but impossible for employers to prevent "wage inflation," and adversely affect our competitive position and our balance of trade. ❁

## How to Halt Inflation

December 29, 1958

Senator Johnson, the Majority Leader, wants Congress to investigate inflation. "We have no clear-cut idea," he says, "of what is causing inflation and what should be done to prevent it."

This is a disheartening comment. Inflation has been progressing in this country for a quarter of a century. Though there may be difference of opinion about details, there is no longer any excuse for ignorance of its main direct cause and cure. The direct cause of inflation is the continuous increase in the supply of money and credit. Most of this is in turn caused by a chronic budget deficit. The cause of the present inflationary fears is precisely the "liberal" spending policies that Senator Johnson and his Democratic majority will be pushing for in the new Congress. The cure would be to abandon these policies.

Though the action of security prices since last summer has been flashing a warning signal for all to see, this warning is being smugly ignored in Washington. Officials offer assurances for the immediate future. But it is the long-range considerations that are causing uneasiness. These have been admirably summarized by the Guaranty Trust Co. of New York in its December survey:

#### THE LONG-TERM VIEW

"In connection with the Federal budget, for example, misgivings do not arise merely from this year's prospective deficit of \$12 billion . . . serious as that is. They arise from the fact that this deficit is symptomatic of a rising tide of expenditure over which no one seems to have any real control. The situation has been developing for a generation and, far from showing signs of correcting itself, appears to be going from bad to worse. Economy drives by the Administration and Congress tend more and more to end in futility. There are too many continuing 'programs' that involve commitments for years in advance—the defense program, the highway program, the housing program, the social-security program, the farm program, the foreign-aid program, veterans' programs, and all the rest.

"Each of these programs, of course, has its own pressure group or groups and its own army of bureaucrats whose jobs depend upon it—and most of whom, no doubt, sincerely believe that, however desirable governmental economy may be as a general principle, their own program is so worthy that it should not only be continued but expanded. The combined result of these programs is a swelling volume of expenditure which, despite tax rates rising to almost confiscatory levels, has produced deficits in 23 of the last 28 fiscal years.

"Yet nowhere in government is there serious talk of abandoning any major spending program. The most that anyone hopes for, apparently, is to retard the rate of growth and oppose the addition of still other programs. This is becoming increasingly difficult as state and local governments call upon Washington for aid. . . .

"It is not the fear of the 1959 deficit, unfortunate as this is, that basically causes distrust of the dollar. It is the growing fear of deficit financing as a 'way of life'."

#### REMEDIES

What can be done about inflation and the growing fear of inflation? We might put detailed remedies under four heads:

1—Futile as it sometimes seems, those who (like Budget Director Stans, Secretary Benson, Senator Byrd, editors, writers, private organizations like the Tax Foundation, and chambers of commerce) have been pointing out in detail where budget economies should be made, must keep up their insistence on specific savings.

2—We are unlikely to get reform until we have a really responsible executive budget. This means that the President must be given at least as much control over (and responsibility for) the Federal budget as, say, the governor of New York has over his state's budget. (For details, see this column, Nov. 23, 1953.)

3—We must recognize the fallacies in the Keynesian ideology, dominant for 25 years, which regards inflation as necessary for full employment and economic growth.

4—We must take the kind of measures spelled out here last week to curb excessive union-leader power and restore confidence in the dollar. ❁



1959





## The GNP Fetish

January 5, 1959

The “national income approach,” once part of the abracadabra of a few statisticians, has now become so widely popularized, not only in economic textbooks but in newspaper discussions, that almost anyone is likely to ask you, or tell you, what “GNP” (gross national product, for the still benighted) is going to be for 1959. Yet a close examination does not justify the exaggerated reliance now placed on these figures. At least five major cautions ought to be kept in mind. Here are two of them:

1—The national income or gross national product figures are arbitrary, and from a strictly scientific standpoint, indeterminate. This was recognized in the pioneer studies. Simon Kuznets, in his two-volumed book *National Income and Its Composition*, published in 1941, pointed out: “The statistician who supposes that he can make a purely objective estimate of national income, not influenced by preconceptions concerning the ‘facts,’ is deluding himself; for whenever he includes one item or excludes another he is implicitly accepting some standard of judgment, his own or that of the compiler of his data. There is no escaping this subjective element.”

### WHAT DO WE INCLUDE?

Kuznets went on to show that estimates of the national income necessarily involve legal and moral considerations. Should we include “the compensation of robbers, murderers, drug peddlers, and smugglers”? And how shall we “draw a line between economic activity and economic goods on the one hand and active life in general and its stream of satisfactions on the other”? Should “washing, shaving, and playing for amusement on the piano” be treated as economic activity? “When judged by the attributes of satisfaction-yielding, scarcity, and disposability, they do not differ from the same activities carried on for money as services to other people (nursing, barbering and giving concerts).”

And yet Kuznets decided (as do practically all national-income statisticians) to include only items that “are dealt in on the market.” This of course excludes all do-it-yourself activities, which in total are now probably enormous. More, it excludes all the products of the family economy, including the activities of housewives. So we get such paradoxes as these: When a man marries his cook, the value of her work disappears from the national-income accounts. When an opera singer sings professionally, she is considered as adding the equivalent of her salary to the national income. When she sings for charity or for friends, it doesn’t count.

### GROSS VS. NET

2—So what we include in or exclude from national income involves arbitrary decision. But a second serious problem is how and where to set the difference between gross and net. How are we to prevent double counting at a thousand points? A married man earns an income of \$10,000. That is the joint income of himself and his wife. He becomes a widower and hires a housekeeper for \$4,000 a year. His income, and their joint income, is still \$10,000; but the national-income accounts would now call it \$14,000. The same problem occurs daily and everywhere. If we count the income of doctors and dentists should we, or should we not, deduct it from the income of patients?

Sliding by this awkward point, how do we separate gross national product (the famous GNP) from national income? Our official statisticians do it by deducting from their GNP figure a “capital consumption” allowance, mainly a “depreciation” charge, and also “indirect business tax and non-tax liability.” But depreciation charges are the results of estimates. The “right” amount of depreciation is never precisely known. Contrary even to the belief of many businessmen, a depreciation deduction is not so much an estimate of past loss as a forecast of future probabilities. It is never known, for example, when an old machine is going to be made obsolete by a new discovery or a new invention. And particularly in a period of monetary inflation, orthodox depreciation charges fail to allow for ever-mounting replacement costs.

There are even more serious defects in national-income estimates, but they will be reserved for a subsequent article. ❁

## More GNP Defects

January 12, 1958

Last week we discussed two of five major defects in the national income or GNP estimates. One was the arbitrary inclusions and exclusions. The other was the difficulty of avoiding duplicate counting or of separating gross from net. Here we will consider the three remaining major defects.

3—National income, to be estimated at all, must be reduced to a common measure—in our case, the dollar. But the value of the dollar is itself constantly changing. In a period of inflation all values are falsified. For 1939 our GNP was estimated at \$91.1 billion; for 1957 it was estimated at \$440.3 billion. Here is an apparent quadrupling, or better, of “gross national product.” But when the government statisticians restate the

figures in “constant dollars” (specifically in “1954 dollars”) they find that the GNP in 1939 has to be raised to \$189.3 billion and that the 1957 GNP has to be lowered to \$407 billion. In other words, “real” GNP did not quadruple but only about doubled in the eighteen-year period.

The government statisticians get this result by dividing actual dollar totals by an index number of prices each year. They print, in fact, a separate table of “implicit price deflators” for the gross national product figures for each year based on an index number of 100 for 1954. The price deflator for 1939, on this basis, is 48.1, and for 1957 is 108.2. If we take the GNP in 1939 at the prices that prevailed in that year it comes, as we have seen, to \$91.1 billion. But if we translate 1957 GNP into 1939 prices, we get, instead of \$440.3 billion, only \$195.7 billion for 1957. This is not nearly as impressive.

#### WHAT DO WE MEASURE?

Moreover, it is possible to correct the comparison only approximately, never accurately, by applying “implicit price deflators.” Goods never remain the same for two years in succession, either in relative quantities or qualities. No index number can be completely “scientific.”

4—In *Newsweek* of Aug. 25, I called incidental attention to a defect in the national-income estimates that throws into doubt the whole question whether these estimates measure comparative “real” income or economic welfare. Larger crops often have a smaller total dollar value than smaller crops. (Hence crop-restriction schemes.) But this merely illustrates a wider principle. Economists have pointed out since the time of Adam Smith that it is not “value-in-use,” but scarcity, that determines “value-in-exchange,” or money price. Water is an indispensable commodity that ordinarily commands no price at all. If more and more things become plentiful (except dollars), the national income, as measured in dollars, might actually begin to fall. If we could imagine a situation in which everything we could wish for was in as adequate supply as air and water, we might have no (monetary) national income at all. Our dollar “national income” figure does not measure total economic welfare, but merely *an internal relationship of marginal values* (multiplied by quantities).

5—The fetish made of national-income figures leads to false ideas concerning cause and effect. The national income is treated as the “purchasing power” that causes and buys the production. Yet the national income is merely the total assumed dollar value of the production itself.

#### SHRINKING YARDSTICK

The fetish made of GNP also leads to false policies. Part of the official GNP total of \$440.3 billion for 1957 was arrived at by including \$87.1 billion for “government purchases of goods and services.” Planners easily jump to the conclusion that if it had not been for these \$87 billion of government purchases the GNP would have been just that much less. Yet whatever government spends it takes away from somebody in taxes.

If the national income falls short of some “goal” by  $x$  billion dollars, economic planners are tempted to assume that the  $x$  billion dollars could easily be supplied by that much deficit financing, or even by printing that much money. We can raise national income to any figure we want, in fact, not by increasing output and consumer satisfactions, but simply by shrinking the measuring rod—by inflation, by depreciating the dollar enough to raise prices to reach that income. ❁

### Heed the Red Lights

January 19, 1958

Since I last wrote here (Nov. 17 and Dec. 8, 1958) about the common market and the free-trade area, major decisions have been taken which mark great steps forward.

The first effects of the rivalry between the six common-market countries—France, Germany, Italy, Belgium, the Netherlands, and Luxembourg—and the proposed free-trade area that would include eleven other European countries have been unexpectedly good. For the common-market countries, in order to blunt British charges of “discrimination,” agreed at the last moment to extend their 10 percent tariff cut, which went into effect Jan. 1, not only to each other but to all nations subscribing to GATT, including the United States. They also offered extension of the first 20 percent increase in quotas to the eleven other European nations.

And when Britain, partly to counter the common market, announced that the pound sterling would be made completely convertible for nonresidents, all the principal European nations felt encouraged or obliged to make a similar announcement. France felt that in order to do so it had to make a still further devaluation of the franc, this time of about 15 percent—from an official rate of 420 to 493.7 to the dollar. In order to offset the shock to confidence, France at the same time announced an anti-inflation program and a “revaluation” of the franc. It dropped two zeros from each unit of 100 francs to create a “heavy franc” with 100 times the purchasing power of the old franc, making it once

more about five to the dollar. It remains to be seen whether the steps France takes will in fact be adequate to convince the world that this is its "last devaluation."

### **FREER TRADE ABROAD**

Nevertheless, the overall effects of the European announcements during Christmas week are of the first importance. The establishment of the common market—together with the initial extension of its benefits to the rest of the Western world—is the most dramatic step taken since the end of World War II toward a lowering of international trade barriers. The establishment of convertibility for the pound and other currencies is the most important single step taken since the war toward a restoration of international monetary order, stability, and discipline.

There have been two other significant developments. The new "heavy" franc is not tied to a round number of American dollars, but made equal to 18/100 gram of fine gold. The European Payments Union, with its automatic credits right, will go out of existence; it will be supplanted by the European Monetary Agreement, under which debt balances must be settled entirely in gold. Perhaps the restoration of the international gold standard is not the vain dream that so many have supposed.

### **INFLATION AT HOME**

But while Europe has been taking giant forward steps, what of the United States? We have been preaching all these fine reforms to Europe, but show no desire to take our own medicine. As Europe is moving toward freer trade, we are moving toward more protection, and particularly toward more import quotas—on farm products, metals, petroleum.

We believe in getting out of recessions, not by internal adjustments, but by more inflation. In the twelve months ending November 1958, notwithstanding unemployment averaging between 6 million and 7 million, average hourly wage rates were pushed up from \$2.11 to \$2.17. We look forward to a budget deficit this fiscal year of \$12 billion. In the twelve months ended October 1958, the country's money supply, as represented by total deposits and currency, increased \$13.6 billion. This was chiefly brought about by the monetizing of government securities. The violent rise of the stock market to new high records, in the face of mediocre corporate earnings, is flashing a signal of lack of confidence in the future value of the dollar. And so is the loss of gold. "Our gold outflow," says the First National City Bank of New York in its January letter, "is saying that the government is spending too much."

The dollar, like Caesar's wife, must be above suspicion. When are we going to heed these signals? ❁

## **Lessons of a Strike**

January 26, 1959

There were many excellent recommendations in the President's State of the Union Message, but his proposals for labor legislation failed to go to the heart of the matter. If we want a glaring example of what our present labor laws and enforcement agencies permit or encourage, we have merely to look at the recent nineteen-day New York newspaper-deliverers' strike.

Let us recall what happened. The deliverers were getting a basic wage of \$103.82 for a 40-hour week for day drivers. The publishers offered them the same package increase previously granted to the Newspaper Guild—\$7 a week spread over two years, \$4 the first year and \$3 the second. This would have made, as of now, about \$108 a week. (Average nationwide manufacturing earnings are \$87 a week.)

The union leaders, after a one-day strike, accepted this offer; but the striking members themselves turned it down by a vote of 877 to 772. Thus 105 men, in effect, precipitated a strike that threw about 17,000 of the 20,000 employees of the nine New York papers out of work. In other words, each man in the plurality that voted to strike forced more than 160 others out of work. The newspapers estimated their loss in revenue at \$25 million. Nearly 6 million readers were deprived of papers.

The indirect losses (even passing over those of big merchants or theaters) were incalculable. Ten thousand of the city's 16,000 newsstands were forced to close during the strike. Candy-store sales dropped violently. People who had rooms to rent couldn't advertise. Job hunters didn't know where to look for work.

### **WHO GAINED?**

Who gained by the strike? Certainly not the strikers. They lost nineteen days' work and pay—at the Christmas season. (The strike ran from Dec. 9 to Dec. 28.) It is difficult for an outsider to see any net advantage in the contract they finally accepted over the contract they struck to reject. According to the publishers' spokesman, they merely accepted the old offer in revised form: Instead of \$4, only a \$3.55 wage increase for the first year, plus Columbus Day as an additional holiday; and instead of \$3, only a \$1.75 increase for the second year, plus three days of paid leave for illness or other personal reasons.

Suppose the strikers, instead of buying a "paid" Columbus holiday for \$23.40 (45 cents a week less, times 52 weeks) had actually gained a paid holiday net by the strike? It would still take nineteen years of such Columbus Days to make up the strike loss. Even if we accept the claim of union members that they "gained"



30 cents a week net, it will take them seven years of work to make up their average strike loss of more than \$400 each. And by inflicting heavy strike losses on the newspapers, they reduced the funds available for future increases in jobs or wages.

### WHAT MADE IT POSSIBLE

What made it possible for 105 men to silence the press of the greatest city in the world? *This* is the question the President and Congress should be asking themselves. Part of the answer is the physical intimidation or coercion the strikers were able to impose. As in 1945, they put a limit on the number of copies (five or *six*) that an individual was allowed to pick up at the publishing plants. The local police in effect enforced such rules. Plenty of truckers were willing, if they had been peacefully allowed to do so, to perform the functions the strikers had abandoned. Some truckers did, in fact, deliver papers all the way from Philadelphia.

What the law and law-enforcement agencies ought to have done, and should do hereafter, is clear. (1) They should forbid mass picketing, or all picketing, however ostensibly “peaceable,” that has in fact an intimidatory effect. (2) They should cease *compelling* an employer to negotiate with strikers. He should be free to announce that all strikers not back at work at a given time would be considered to have resigned their jobs and that others would be permanently hired in their place.

Or do we believe that a tiny but muscular minority should have the right, at will, to close down the press of a great city unless its demands are met? ❁

## Schizophrenic Budget

February 2, 1959

Because the Democratic majority in Congress seems bent on reckless inflationary spending, and is criticizing only the economies and not the extravagances in the President's budget, there is a temptation to defend that budget as it stands and to praise it as at least an effort toward a balance. But the budget cannot be defended as it stands and it is hard to believe in the “balance” it depicts.

This balance is precarious on its face. To get his estimated budget receipts up to \$77.1 billion, the President had to assume an increase in tax revenues of \$9 billion for the fiscal year 1960 over 1959, with practically no increase in tax rates or levies. To get his estimated expenditures down to \$77 billion, he had to assume a drop of \$3.9 billion compared with 1959 in spite of proposed increases in many spending programs and his own failure in the last calendar year to veto huge

Congressional appropriations that he had not asked for. Most of the “decline” in 1960 expenditures, moreover, is achieved by charging the \$1.4 billion proposed increased subscription to the International Monetary Fund against expenditures for the current year instead of against 1960.

### PAST MISCALCULATIONS

Nor does the record of the past two years increase confidence in the accuracy of Mr. Eisenhower's present estimates. For the fiscal year 1958 he projected a budget surplus of \$1.8 billion; we emerged with a deficit of \$2.8 billion. For 1959 he predicted a surplus of half a billion; we now face a deficit of \$12.9 billion. Receipts of the present fiscal year will be \$6.4 billion less than his estimate a year ago; expenditures will be \$7 billion more.

Even if we take the new budget at face value, we must remember that it is the biggest budget Mr. Eisenhower has ever proposed. Nor can this be blamed on defense necessities. For it contains the highest non-defense expenditures ever recommended. These total \$31.2 billion, compared with \$28.1 billion recommended for 1959 (though increased in actuality), and with nondefense expenditures of \$27.8 billion in 1958, \$25 billion in 1957, and \$21.2 billion in 1954. In brief, nondefense expenditures alone are \$10 billion greater than in 1954.

Nor does even this tell the full truth about the overall budget. In recent years, the cost of government activities such as social security and highways has been hidden in special segregated budgets. When we put them in a “consolidated” budget, we find that Mr. Eisenhower is really planning to spend in 1960 a total of \$92.9 billion.

### THE ITEM VETO

And Mr. Eisenhower's latest budget suffers from the very “schizophrenia” toward economy and spending of which he accuses its critics. On the one hand, he insists that we must “keep our financial house in order” and “examine new programs and proposals with a critical eye. Desirability alone is not a sound criterion for adding to Federal responsibilities.” We must “restrain the forces that would drive prices higher, and thereby cheapen our money and erode our personal savings. The first step is to avoid a deficit by having the government live within its means, especially during prosperous, peacetime periods.” But then he recommends continuation of and increases in so many welfare programs that there is not space to list them here. He even declares proudly that we must “carry forward current public-works programs—now larger than ever before.”

But there is one recommendation in the President's message that can be endorsed with the sole reservation that it does not go far enough. This is that the President should be given the constitutional power not only to veto individual items in appropriations bills, but to reduce the amount of any appropriation. This power would not in itself, of course, insure a responsible budget. But we can never have a responsible budget, or anything approaching a responsible budget, until this power exists. At present the so-called executive budget is merely a speech which Congress is free to ignore. The President cannot fairly be held responsible for the budget until he has the power to carry out that responsibility. Congress is in no position to blame him for a result that he lacks the power to control. ❁

## Who Makes Inflation?

February 9, 1959

The *Economic Report of the President* reflects the same schizophrenic attitude toward spending vs. economy, inflation vs. dollar-integrity, as his Budget Message. At one point he declares: "An indispensable condition for achieving vigorous and continuing economic growth is firm confidence that the value of the dollar will be reasonably stable in the years ahead." But most of the report endorses policies that would clearly undermine this confidence.

Describing governmental actions that helped "to bring about a prompt and sound recovery" he says: "Monetary and credit policies were employed vigorously to assure ample supplies of credit. Legislation was enacted to lengthen temporarily the period of entitlement to unemployment benefits. Numerous actions were taken to spur building activity. Steps were taken to accelerate Federal construction projects already under way and to speed up projects supported by Federal financial assistance. Activities under a number of Federal credit programs, in addition to those in the housing field, helped counter the recession. And the acceleration of defense procurement exerted an expansive effect."

### WHO PRINTS MONEY?

Every one of these policies was inflationary. All of them meant pouring new money and credit into the system, increasing the supply of dollars, reducing their individual purchasing power. In a later part of the report it is admitted that the Federal Reserve policies enabled the commercial banks "to add nearly \$10 billion in loans and investments to their assets," largely by "additions

to their holdings of U.S. Government securities." This in turn added \$13.6 billion to the total money supply (including inflated time deposits), and helped to boost living costs.

Yet the President's report blurs responsibility for inflation and tries to shift it onto consumers, business, and labor. The "individual consumer" is advised to "shop carefully for price and quality"—as if he couldn't be depended upon to do that without urging. The government in effect is saying to consumers: "Here are \$10 billion or more additional paper dollars; but don't be reckless enough to spend them, because it will make you responsible for raising prices." "Businessmen" are told they "must wage a ceaseless war against costs"—as if self-interest and self-preservation did not insure that. But nothing is said about Federal labor laws (including compulsory exclusive "bargaining") which render the employer all but impotent in resisting excessive demands. And "leaders of labor unions" (after having been granted monopolistic bargaining powers by law) are urged not to ask as much as they can get under these conditions. This means that they would not last very long as labor leaders.

### THE REAL CULPRIT

The President goes on to declare: "If the desired results cannot be achieved under our arrangements for determining wages and prices, the alternatives are either inflation, which would damage our economy and work hardships on millions of Americans, or controls, which are alien to our traditional way of life and which would be an obstacle to the nation's economic growth and improvement." What the President seems to be saying is that it is consumers, businessmen, and labor leaders who threaten to bring inflation by lack of "self-discipline and restraint," and that they may "force" government controls. But the real culprit is government. Government must stop deficit spending, stop flooding the country with more paper dollars, and stop encouraging monopoly in the labor field while blaming "our free competitive economy" for rising wages and prices.

Perhaps the most important recommendation in the *Economic Report* is that Congress "amend the Employment Act of 1946 to make reasonable price stability an explicit goal of Federal economic policy, coordinate with the goals of maximum production, employment, and purchasing power now specified in that act." Well, if the mischievous Employment Act of 1946 is to be retained, this amendment on net balance would probably make it less mischievous, because the act has been constantly interpreted as a directive to inflate. But an immensely better solution would be to repeal the act altogether. ❁

## What Russian Trade?

February 16, 1959

In past articles I have called attention to some of the fictions and fallacies in recent hysterical comparisons between Soviet Russia's alleged "rate of economic growth" and our own. But supposedly responsible American publicists, in and out of government, continue not only to swallow the Soviet boasts without adding even a grain of salt, but to draw conclusions that would be flagrantly fallacious even if the boasts were reliable.

One of the latest developments to arouse these viewers-with-alarm has been "the Soviet challenge in foreign trade." In their front-page anxiety about this they are merely acting as megaphones for official Communist propaganda, as illustrated, for example, in Mikoyan's statement in Moscow on Jan. 31 in favor of "peaceful competition in cooperation with other countries in developing the economies of the underdeveloped nations," etc. Before we ask how "peaceful" this "competition" has been or is likely to be, we may begin by putting the subject in factual perspective. Just how important, relatively, has Russian buying and selling been? How does Russia rank in international trade?

It should not be too difficult to answer that question, at least in approximate terms. The official figures are available. It is merely necessary to have sufficient enterprise and industry (like Alice Widener, for instance, in *U.S.A.* magazine for Feb. 13) to dig them up and interpret them. They are to be found among the 777 pages of the United Nations *Yearbook of International Trade Statistics*.

### SOVIET 'STATISTICS'

According to the U.S.S.R.'s own official figures, it had total exports of 17.5 billion rubles in 1957 and 15.8 billion of imports. If we accept these figures at face value, the next question is how to convert them into dollars for purposes of comparison. The official rate of the ruble is 4 to the dollar. The U.N. tables solemnly convert it at that rate. Even at that rate, we find that the Soviet Union did only 2 percent of world trade in 1957. And we find that total U.S.S.R. exports to the free world in 1957 (after deducting "trade" with the Russian satellites and Red China) amounted at that rate to only \$966 million. This is less than 5 percent of the total exports of \$20.6 billion from the United States in that year.

But the official 4-to-1 rate for the Russian ruble is a flagrant fiction. Foreign-currency dealers in New York will sell you rubles at 25 or more to the dollar and will buy rubles at 50 to the dollar. If we are unkind enough (as Mrs. Widener is) to convert rubles into dollars at a rate of 24 to 1, we bring Russian exports to the free

world in 1957 down to a value of only \$161 million. This is less than the gross exports in that year of a single American company, like General Electric. If, generously, however, we convert rubles at the official tourist rate of 10 to the dollar, we get total 1957 exports to the free world of \$386 million. This is less than the U.S. Government spends every two days.

### A NEGLIGIBLE FACTOR

About 73 percent of Soviet exports go to other Communist countries. But even if we convert the U.S.S.R.'s total exports in 1957 of 17.5 billion rubles at the tourist rate of 10 to the dollar, we get only \$1.8 billion. This is not only less than one-tenth of U.S. exports of \$20.6 billion; it is only one-fifth of the 1957 exports of West Germany (\$9 billion), and it is about equal to the exports of little Switzerland (\$1.6 billion) with a population 1/40th as large as the Soviet Union. And it is by no means certain that a conversion rate of 20 or 25 to 1 for rubles into dollars would not be more realistic than the tourist rate of 10 to 1.

Nor can these ridiculously small exports be attributed to American "discrimination" against Russia since 1947. Soviet Russia has always been a negligible factor in world trade. In 1938, the last full year before World War II, American exports to the Soviet Union were valued at about \$70 million, and our imports from the U.S.S.R. in the same year were valued at about \$24 million.

Finally, as the Russian satellites and such reluctant victims as Finland have discovered, "trade" is something that Soviet Russia forces on weaker neighbors as a form of tribute or extortion. But that's another story. ☸

## Uncurbed Union Power

February 23, 1959

No one concerned for the protection of the public interest against the almost unlimited power of labor bosses can become enthusiastic about either the Kennedy-Ervin or Administration bills now before Congress.

Both bills, it is true, purport to protect union members against corrupt or unscrupulous union bosses. But both mistake the means. Congress, having by the enactment of special privileges and immunities created the Frankenstein monster of lawless union power, now seeks by still more government intervention to curb a few of the abuses of this power. Both bills carry elaborate provisions requiring financial statements from unions, and opposing bribery and corruption. There are already enough laws against robbery, embezzlement, and misappropriation of funds. It is merely necessary to enforce them. The real evils are compulsory



membership in unions and exclusive bargaining powers. These neither bill dares to touch.

Both bills, on the contrary, contain provisions which would merely increase the power of unions and of union bosses. The Kennedy-Ervin bill would extend union dominion over many supervisors. Both bills would allow replaced strikers to vote in representation elections. This would permit former employees to choose “representatives” for present employees. It would tend to keep former union bosses in power and put pressure on the employer to fire replacements. The real reason some unions acquiesce in the Kennedy-Ervin “reforms” is that they want such provisions and accept the “reforms” as innocuous or meaningless. Both bills place still more discretionary power in the hands of the National Labor Relations Board, which has flagrantly misused the discretionary powers it already has.

### COERCIVE PICKETING

The Administration bill amends the provisions of the Taft-Hartley Act against secondary boycotts; but instead of making those provisions clearer and stronger, it virtually authorizes some of the worst forms of secondary boycotts.

The Administration bill contains at least one good provision, the only trouble being that it does not go nearly far enough. This is the provision to outlaw “stranger” or “black-mail” picketing—i.e., picketing by people who are neither employees of the employer picketed nor representatives of those employees. This kind of picketing can ruin a small-businessman. It has become a weapon of extortion and shakedowns.

But a recital of the few virtues of the Administration bill, and the even fewer virtues of the Kennedy-Ervin bill, only serves to emphasize the extent to which both fall short of the reforms that are desperately needed. Why should reform be confined, for example, only to “stranger” or “extortion” picketing? Should mass picketing be tolerated, even for so-called “legitimate” purposes?

### FOR REAL REFORMS

Even Senator Kennedy said during the Kohler hearings: “It does not seem [that] there is any defense of mass picketing.” And he refused to concede that there is “any justification for a minority or even a majority to place themselves in such a position that others cannot do what they desire to do.” But this recognition of reality did not get into the Senator’s bill. Surely all mass picketing, as well as all picketing that has an intimidatory effect, should be prohibited.

The two labor bills now before Congress merely serve to deflect public attention away from the real evils of uncurbed union power. They seem to be drafted

mainly on the assumption that labor bosses can do no wrong except to union members. The plight of non-union workers, employers, and the consuming public is largely ignored. The central evils of legalized violence and monopolistic compulsion are left untouched.

Real steps to reform would be amendment of the Taft-Hartley Act to remove the exclusive bargaining powers granted to unions, and to prohibit all devices that tie employment to union membership. Still another would be complete repeal of the Norris-LaGuardia Act. As Prof. Sylvester Petro puts it: “There is no excuse for a law which denies injunctive relief to persons suffering irreparable injury from clearly and plainly unlawful conduct.” ❁

## The ‘Growth’ Game

March 2, 1959

A few weeks ago Nikita Khrushchev, in the course of a seven-hour speech, called for an 8.6 percent annual increase in Soviet production. He said that the United States’s annual increase was only 2 percent. This set off a fresh alarm among the 5-percent-or-bust addicts over here.

Edwin L. Dale, Jr., in *The New York Times*, went Khrushchev one better. In allowing us a growth of 2 percent a year, he wrote, Khrushchev “was being unnecessarily kind because “after correcting for higher prices” our own growth rate since the end of the Korean war “has averaged less than 1.5 percent.” Barbara Ward, also in *The New York Times*, demanded an “Atlantic world” growth of 5 percent a year, to be achieved by an “increase in government activity.” Walter P. Reuther, head of the United Automobile Workers, told Congress that the nation could solve most of its problems by achieving a 5 percent annual growth in the economy—by (as one might guess) more spending and “higher wages.”

### WHY 5 PERCENT?

It is difficult to know where to begin in analyzing all the confusions and false assumptions involved in these rates-of-growth comparisons. I discussed five of them in an article last summer (*Newsweek*, Aug. 25, 1958). There is space here only to mention two: (1) There is no reason for assuming any Russian statistic to be honest. (2) It is more than doubtful whether *overall* “economic growth” is accurately measureable even by “objective” statisticians. All such measurements rest on arbitrary assumptions.

But suppose we ignore these fundamental difficulties. Why the mania for a growth rate of 5 percent? Of course once the magic figure of 5 percent is suggested



as a “goal,” no one dares to say that he would be smugly content with a growth rate of a miserable 3 or 4 percent. But why don’t our starry-eyed “liberals” really set their sights high? Why don’t they at least try to better the Khrushchev goal of 8.6 percent per year? What’s wrong with a growth rate of 10, or 20, or 50 percent a year?

If we are trying to talk about realities rather than dreams, it becomes pertinent to ask just how realistic the 5 percent growth figure is. One of the few hard-headed comments I have seen on this is that of Jules Backman of New York University, who points out that an annual rate of growth of 5 percent in gross national product, compounded, would result in a gross national product sixteen times that of the present figure within slightly more than half a century.

### PERCENTAGE TRICKS

In my article last August, I pointed out that our “unfavorable” growth rate compared with Soviet Russia depends in part on a trick of percentage figures. The smaller the base from which you start, the easier it is to attain a high percentage growth rate; the bigger the base, the harder.

Take the history of a specific economic product—television. Output in 1946 was 7,000 sets. In 1947 it was 200,000—growth rate, 2,757 percent. In 1948, it was 975,000 sets—growth rate, only 387 percent. In 1949 output rose to 3,029,000 sets—but growth rate was only 211 percent. In 1950 production jumped to 7,464,000 sets; but growth rate was only 146 percent. Though output was accelerating enormously in absolute amounts, *percentage rate* of growth was constantly falling. And since 1950 the rate of growth has *stopped entirely*. Yet we have continued to turn out from 5 million to 7 million sets a year.

This brings us to steel. Grave concern has been expressed because United States steel output *fell* to 78 million metric tons in 1958 from 102.5 million in 1957, whereas Russian steel production *increased* to 54.9 million tons from 51 million in 1957. But the U.S. increased steel *capacity* 6 million tons last year, compared with an apparent Russian increase of 4 million. Our percentage rate of increase was less than Russia’s. But our real increase was more. This means that, in real terms, we are even farther ahead of Russia in steel capacity than we were a year ago! As long as we can maintain such an absolute annual lead, Russia can never catch up.

Our rates-of-growth alarmists are scared stiff by their own false assumptions and statistical fallacies. ❁

## Wrong Aims and Means

March 9, 1959

The recent agitation for a high “rate of economic growth” tends to divert attention from the real menace that confronts us. That menace is the immediate striking power of the Soviet Union. While public attention is focused on the danger of intercontinental ballistic missiles, some Navy specialists think that a much more immediate danger is Russia’s 450-odd submarines. Rear Adm. John S. Thach, on Feb. 17, estimated that if the Russians had submarines firing effective ballistic missiles, as they have contended, and if as many as a dozen could get through our defenses undetected, they could wipe out 70 percent of the nation’s industry in one surprise blow.

Now such a menace cannot be countered by producing more automobiles and stereophonic sets, or by competing with Russia for a mere overall rate of economic growth. In the type of war most probable tomorrow, or even today, general economic potential is unfortunately likely to count for little compared with immediate 24-hour striking power or retaliatory power.

### PRODUCTION VS. RATES

This of course is not the only way in which the rate-of-growth fetishists misconceive our real goals. They are victims of an elementary statistical fallacy. This fallacy, as I pointed out here last week, is dramatically illustrated by output of television sets since 1946. Though *rate* of growth has dropped below zero, absolute growth has been enormous. Between 1946 and 1947, output of television sets increased by an absolute amount of 193,000. This was at a *rate* of 2,757 percent. Between 1949 and 1950, output increased by an absolute amount of 4,435,000 sets. But this was at a *rate* of only 146 percent. Since 1950 there has been no net increase in the rate of television output, but a decrease. Yet present output is about 5 million sets a year, compared with 7,000 in 1946. And the total number of television sets in use is greater than ever.

The same pattern of growth (though, of course, at different rates and over different periods) can be traced for housing, railroads, automobiles, airplanes, radio or hi-fi sets, or any product whatever. The pattern can be found even in the growth rate of human beings. From the day of birth a boy grows in weight an average of 195 percent in his first year—a record which he never even approaches thereafter.

The trick is to start from a small enough base. Insofar as even a provisional credence can be given to Soviet statistics, this is the chief explanation of Russia’s higher rate of industrial growth compared with our own.

## WRONG POLICIES

Economically, for special products, in sum, the rate or curve of growth is steepest at the beginning and then tends to level out. This falling rate of growth is both inevitable and sane. When practically every family has an automobile, a refrigerator, or a television set, there is no reason for further production except for replacement. And this eventually tends to become true even of total levels of consumer goods output and consumption. As even Barbara Ward admits: "If a family has an income of \$20,000 a year it should in all sanity be content with a smaller increase than a family with only \$2,000." Unfortunately, her subsequent discussion forgets this momentary flash of insight.

Finally, practically all the rate-of-growth agitators propose exactly wrong means to achieve their declared aims. Most of them want to do it by mere inflation—i.e., by deficit spending and money printing so that the same physical product is priced higher every year in terms of rotting dollars. Barbara Ward wants an "increase in government activity"—i.e. more deficit spending and more hampering interventions which can only reduce production and divert it products that consumers desire less. Walter Reuther has the worst suggestions still—more punitive taxation and a still further increase in automobile wage-rates which would further discourage both production and employment.

None of the growth raters mention the one thing that would do most to increase real wages and national productivity—policies to encourage more saving and capital investment. ❁

## 1985?

March 16, 1959

Some of us thought that George Orwell, in *1984*, had portrayed the horrible daily life and terror of a totalitarian socialist regime with classic power and finality. But today actualities surpass what even first-rate scientists were able to imagine.

A vivid report from Red China, for instance, was recently made in three articles for the Associated Press by an Indian social scientist, Dr. Sripati Chandrasekhar. Except for their final paragraphs, these articles are written in a detached tone. They even make some favorable generalizations, though these violate probability. Admitting that there was famine three years ago, the articles say, for example: "No one starves in China now." No one? That would be a risky statement to make even about the United States, the best-fed country in the world. It becomes particularly implausible about Red

China when we recall the chronic famine among its estimated 650 million population, the starvation in Soviet Russia and elsewhere whenever swift collectivization was imposed, and the 2 million farm landlords that the Red Chinese are estimated to have executed. The official claims of a 100 percent increase in food production in 1958 over 1957 are preposterous on their face.

## NIGHTMARISH PICTURE

Not that the Chinese Communists are not making great efforts. A Hong Kong dispatch to *The New York Times* of Feb. 23 tells how "factory and office workers, students, housewives, and army units from towns and cities have joined the rural population in a massive shock campaign of manure collection." As the *People's Daily* of Peking points out: "Manure can be found everywhere."

But to return to Dr. Chandrasekhar. When he is not merely retailing Chinese official propaganda, but reporting what he actually saw, he paints a nightmarish picture. It is a picture of men and women of all ages working day and night. He personally counted eighteen structures being built around the clock, with the aid of artificial light at night.

"Everyone, men and women of all ages, is dressed in blue trousers and buttoned-up coats," looking like "an endless army of blue ants." No one can escape the ubiquitous wired radio loud-speaker. "The radio blares away at you in the bus, in the train, in the trolley, in sleepers and dining cars, on street corners, in villages, towns and cities." What it blares out is how to make a smelter, how to defeat the American "imperialists," how to be a good Communist, how to denounce the rightists. The relaying loudspeaker "cannot be controlled and cannot even be turned off."

Chinese women have achieved "equality." That is, they do the work of men, and "can and do denounce their husbands at party meetings if they suspect them of rightist and bourgeois tendencies."

## A CHINESE COMMUNE

Chinese Communist officials are proudest of their latest development, the communes, where they have gone beyond the Soviet Union. Dr. Chandrasekhar describes the "best" one, a "showpiece." It was made up of 68 villages. "The houses, the land, the implements, the cottage industries, and the kitchen utensils were all owned by the commune." It managed 228 public canteens where all adults ate in hostel-type dining halls. The adult population was distributed over 146 productive "teams."

Men and women wake up in the morning to the blare of loudspeakers in the streets. After half an hour of exercise in the open air they go off to the canteens for a communal breakfast. After the day's toil in the fields

and factories, all attend regular classes. There they listen to propaganda on the radio. Last is the party meeting, which every worker attends. People rise up, confess their failings, and criticize their colleagues.

At the end of his factual report, Dr. Chandrasekhar sums up: "This is the commune where human beings are reduced to the level of inmates in a zoo. But there is a difference. The animals in a zoo do not have to work hard, and, what is more, they do not have to listen to the quasi-compulsory radio. The lack of peace and quiet in the countryside, where no one can retire and reflect, and the lack of privacy and solitude are to me more terrifying than all the hells put together." ❁

## Spending and Taxing

March 23, 1959

The spenders and the inflationists are in the saddle, both in Congress and in an influential part-of the press. Actual advocacy of inflation (as typified by Sumner H. Slichter) becomes constantly more open, as does advocacy of still more reckless spending. And now a new type emerges—the defender of increased spending in all directions who professes at the same time to be against inflation, and who therefore proposes even more burdensome taxation.

Take, for example, a column by Walter Lippmann in *The New York Herald Tribune* of March 5. "Neither the Administration nor the Congress," he writes, "shows any sign of being willing to vote the taxes which are absolutely essential if the budget is to be balanced. As of now, both parties regard as untouchable the income-tax rates which were fixed in 1954, the date of the Eisenhower reduction"; these are accepted as "sacrosanct."

What Lippmann is saying, in effect, is that every dollar of the \$77 billion (really \$93 billion) that the President is proposing to spend in the fiscal year 1960 is a sacrosanct and untouchable expenditure. Not once does he suggest in his article that any saving is possible anywhere. Every dollar, he implies, that either the Administration or the Democrats want to spend is essential to meet our "needs." Among these he specifies not only national defense, but foreign aid and "education and public facilities."

### COST OF NONDEFENSE

Let us look at this budget; and let us, for the sake of argument, grant the spenders' tacit assumption that there is no waste whatever in any category of our military expenditures and that all of these are indeed

untouchable—except in an upward direction. We still find that *nondefense* expenditures proposed for 1960 come to a record \$31.2 billion, compared with \$21.2 billion in 1954. This is an increase of \$10 billion. But the spenders apparently cannot think of a single place to cut it.

Lippmann thinks we are "too soft and too timid to tax ourselves enough." I suggest that we are, on the contrary, too soft and too timid to call a halt to the preposterous handouts to special pressure groups. We are spending more than \$6 billion a year for farm subsidies alone. These raise food prices for city workers at the same time as they bring into existence huge unsalable farm surpluses that we try to dump abroad. If we swept out the whole farm-subsidy program it would save \$6 billion, bring us a far healthier economy, and vastly improve our foreign relations. Veterans' aid at \$5 billion a year is shamelessly swollen. We have little to show except suspicion and resentment (e.g., Bolivia) for the \$62 billion we have lavishly distributed since World War II in foreign aid. All this is not to mention Federal aid to education, Federal housing, aid to "distressed areas," and the rest.

### CONFISCATORY RATES

Now let us look at the soft and timid income-tax rates that Lippmann is so eager to raise. Personal income-tax rates now rise to the confiscatory level of 91 percent. How much higher would he raise them? And how much additional revenue would the increase in rates bring in? The Tax Foundation has pointed out that in 1956 (the latest year for which data are available) all the rates above the lowest-bracket level of 20 percent brought in only 14 percent of the total income-tax yield; the other 86 percent came from the 20 percent rate. We also know that all rates over 50 percent brought in less than \$800 million, or only 2½ percent of the total income-tax yield.

It does not follow that halting the top income-tax rate at 50 percent would mean the loss of this small revenue. On the contrary, there is every reason to suppose that with such lower rates actual revenues would *increase*. The government's revenues in 1954 were \$64.7 billion. Three years after the tax cuts were made which Lippmann now deplores, revenues rose to \$71 billion.

Those who want to raise tax rates even further now, instead of cutting government extravagance and waste, forget how much our existing personal and corporate tax rates already retard potential economic growth, and how dangerous to our productivity a still further rate increase would be. ❁



## More Inflation Ahead?

March 30, 1959

Notwithstanding all the reassurances from Washington, the American public believes that inflation is here to stay. It has been saying this by its actions—most dramatically in the stock and bond markets. On March 13 the Dow-Jones industrial average reached 615, up 175 points from April 7 of last year. As one shrewd observer put it: “The stock market is in orbit. It has been thrust free of the gravitational pull of a declining bond market.” The Dow-Jones stocks have been selling at 21 times their \$29 1958 earnings and at seventeen times even of a projected \$36 for 1959 earnings. As of March 11, the average yield of 500 common stocks, as compiled by Standard Statistics, was only 3.23 percent, compared with an average yield of 4.20 percent for A-1 bonds.

The rise of stocks and the decline of bonds have been twin results of an inflationary psychology. Momentary breaks do not necessarily herald a reversal of this long-time trend. Regardless of what stocks are at present yielding, holders believe that inflation will cause them to sell still higher in the future (if only in terms of a further depreciated dollar), and that they will receive, if not a good yield, at least a “capital gain.” For the same reason “safe” bonds even at a 4 percent yield do not interest investors when they expect the dollar face value of these bonds to decline in real purchasing power.

### REASONS FOR FEAR

This spreading belief that inflation is here to stay, this resignation and adjustment to it, is premonitory. It helps to create or intensify the very consequences it fears. And it is not set at rest, but increased, by complacent assurances from congressmen that there is really nothing to it—just a baseless bugaboo. For the business and financial community merely draws the conclusion that Washington even now refuses to recognize the danger, or to take the steps necessary to avert it.

The business community judges the outlook not merely by what is said but by what is done. Here are reasons that lend substance to its fears:

1—After twenty years of inflation most congressmen still do not understand that the basic cause of inflation is the increase in money and credit. The active money supply has been expanded from \$36 billion at the end of 1939 to \$138 billion at the end of 1958—an increase of 283 percent.

2—With one rationalization after another, there have been 25 budget deficits in the last 29 years, during which the national debt has risen from \$16 billion to \$285 billion. The public believes that deficits are here

to stay. Few persons believe that even the President’s proposed budget for 1960 would really balance at \$77 billion. We are certain to have a dangerous deficit if the Congressional spenders have their way.

3—The Federal Reserve authorities showed reassuring courage when they raised the discount rate of four reserve banks from 2½ to 3 percent on March 6. But this also called attention to the lack of courage and wisdom they showed in dropping the discount rate from 3 percent to the inflationary level of 1¾ percent last year. In the last quarter-century the Federal Reserve Board has been under practically continuous pressure to keep inflating. Over the long run it has yielded to this pressure. When it acts with restraint and courage, as now, it is subjected to a political barrage. Typical is the statement of Senator Douglas (who knows better) that: “This action certainly seems extraordinary in view of the 4.7 million people who are fully unemployed and the equivalent of another 1 million who suffer from involuntary part-time employment.”

4—The chief reason for present unemployment, *with* inflation, is the excessive wage rates imposed on employers, particularly by industrywide unions such as those in automobiles and steel. These unions have been pricing their members out of the market. Yet as long as they keep automatic escalator clauses in their contracts, even more inflation is unlikely to float them into full employment.

5—The only way in which this process can be stopped is by modification or repeal of Federal labor laws passed since 1932 which make employers impotent to combat unreasonable demands. But Congress shows not the slightest interest in or stomach for such reform. ⚙

## Inflation as a Policy

April 6, 1959

In his classic little history of fiat money inflation in the French Revolution, Andrew D. White points out that the more evident the evil consequences of inflation became, the more rabid became the demands for still more inflation to cure them. Today, as inflation increases, apologists emerge to suggest that, after all, inflation may be a very good thing—or, if an evil, at least a necessary evil. The chief spokesman of this group is Prof. Sumner H. Slichter of Harvard.

Slichter’s testimony and writings overflow with fallacies. I confine myself here to three: (1) That a “creeping” inflation of 2 percent a year would do more good than harm. (2) That it is possible for the government to



*plan* a “creeping” inflation of 2 percent a year (or of any other fixed rate). (3) That inflation is necessary to attain “full employment” and “economic growth.”

I long ago pointed out (*Newsweek*, Sept. 23, 1957), as did others, that even if the government could control an inflation to a rate of “only” 2 percent a year, it would mean an erosion of the purchasing power of the dollar by about one-half in each generation. This cannot fail to discourage thrift, to produce injustice, and to misdirect production. Actually inflation in the United States has been much faster. The cost of living has more than doubled in the last twenty years. This is at a compounded rate of about 4 percent a year.

### IT CAN'T BE PLANNED

The moment a *planned* “creeping” inflation is announced or generally expected in advance, it must accelerate into a gallop. Even Slichter now recognizes that, if lenders expect a 2 or 4 percent rise of prices a year, they will insist that this be added to the interest rate otherwise paid to them to maintain the purchasing power of their investment. But he still fails to see that all businesses will be forced to offer a correspondingly increased gross rate of return to attract new investment, even new equity capital. He still fails to see that if there is a planned price rise, union leaders will simply add the expected amount of that rise on top of whatever wage demands they would have made anyway. He still fails to see that speculators and ordinary buyers will try to anticipate any planned price rise—and thereby inevitably accelerate it beyond the planned percentage. He still fails to see that inflation forces everybody to be a gambler.

The burden of Slichter's argument now is that “a slow rise in the price level is an inescapable cost of the maximum rate of growth”—in other words, that inflation is a necessary cost of “full employment.” This is simply not true. What is necessary for maximum “growth” (i.e., optimum employment and maximum production) is a proper relationship or *coordination* of prices and wages. If some wage rates get too high for this coordination, the result is unemployment. The cure is to correct the culpable wage rates. To attempt to lift the whole level of prices by monetary inflation will simply create new maladjustments everywhere.

### COORDINATION NEEDED

In brief, if a real coordination of wages and prices exists, inflation is unnecessary; and if coordination of wages and prices does not exist—if wages outrace prices and production—inflation is worse than futile.

Slichter assumes that there is no way to restrain excessive union demands except by “breaking up” unions. It never occurs to him that we need merely repeal the special immunities and privileges conferred

on union leaders since 1932, especially in the Norris-LaGuardia and Wagner-Taft-Hartley acts. If employers were not legally *compelled* to “bargain” with (in practice, to make concessions to) a specified union, no matter how unreasonable its demands; if employers were free to discharge strikers and peaceably to hire replacements; and if mass picketing and violence were really prohibited, the natural competitive checks on excessive wage demands would come into play.

Slichter argues that labor unions are much the most important cause of present-day inflation, yet contends at the same time that a general wage increase is just the right medicine for the economy right now! His delusion is that we can inflate ourselves out of the inflation. ❁

## What Is Competition?

April 13, 1959

*The Roots of Capitalism*, by John Chamberlain (Van Nostrand, \$5.50), is a book unapologetically in praise of the American system of free enterprise. It is a history of the ideas, the men, and the deeds that produced the capitalism of the present day. The ideas include liberty, freedom of choice, private property, limited government, and contract. The men include the economic theorists from Adam Smith to Ludwig von Mises, the political theorists from John Locke to James Madison, and inventors and enterprisers like James Watt, Eli Whitney, and Henry Ford.

Chamberlain interweaves fascinating thumbnail biographies and portraits with a discussion of abstract principles. As he writes in his preface, for years the system we call capitalism was on the defensive, because it existed in the here-and-now, and its imperfections, whether inherent or not, were plainly apparent to everybody. When contrasted with a dream of perfection, such as socialism, capitalism was manifestly at a disadvantage. But since the advent of socialist economies, as in Communist Russia and China, and of the semi-socialist or “mixed” systems of Scandinavia, Britain, and New Deal America, capitalism “no longer requires apologists. Under any comparative audit of systems it comes out very well indeed.”

### ‘ADMINISTERED PRICES’

Chamberlain defends capitalism against some of the more persistent current criticisms of it. One of these is that real competition has disappeared in America, and has been supplanted by “administered prices,” by monopoly or “oligopoly,” or by “imperfect” or “monopolistic” competition.

The term “administered prices” was invented by Gardiner Means in the early New Deal era and is being exhumed today by Senator Kefauver. It turns out to be merely a sinister name for a price established or quoted by the seller. Quoted prices are immemorial. As Roger Blough of the U.S. Steel Corp. has pointed out, they can be found anywhere, from the corner newsstand to Macy’s. It is only when a firm has the “market power” to make the “established” or the “quoted” price stick through periods of declining sales and unused manufacturing capacity that competition ceases to be the governor of market transactions.

And as Chamberlain conclusively shows, this power very seldom exists in present-day America. The presence or absence of competition seems to have very little to do with the size of the units involved. “It can be absent in a small town . . . where the barber or the hardware-store proprietor has a local monopoly. It can be present among automotive giants when they are engaged in a dingdong battle for sales leadership.”

#### ROLE OF INNOVATION

This is being illustrated afresh by the present plight of the Buick. In 1955 it was the most popular medium-priced car. But it has now dropped from third place to sixth in its share of the American market. Its sales are down so far in 1959 (according to *The Wall Street Journal* of March 24), 61.2 percent from their best pace. Chamberlain brilliantly shows the terrific price as well as quality competition that the American automobile companies are under. For example, there are upwards of some 50 million cars on the roads of the U.S., and “each one of the 50 million is in the hands not only of a buyer *but also of a potential seller*.”

Recent economists have gone sadly wrong in their postulate of something they call “perfect” competition. Compared with this, all actual competition seems to them “imperfect” or “monopolistic.” As F.A. Hayek pointed out a dozen years ago, their “perfect” competition, on analysis, seems to mean “the absence of all competitive activities.”

Chamberlain follows up the Hayek lead with a beautifully lucid exposition of what real competition means today. The characteristics of the so-called “perfect” market—an undifferentiated product, many buyers and sellers, no trade secrets—are built on the analogy of the wheat market. They have never applied to industrial competition. Industrial competition is not merely competition in prices; it is competition in product, in improvement, in innovation—in short, in the very “differentiation” that the theorists deplore as an “imperfection.” ❁

## Why There Are Jobless

April 20, 1959

On April 7 the government triumphantly announced that employment rose 1,106,000 and unemployment dropped 387,000 between mid-February and mid-March to 4,362,000. The drop for the two months was the largest in any year since 1950. But though there is cause for some gratification in this, it is not the basic answer to the barrage of propaganda from the labor-union bosses and the left-wing Democrats seeking to pin the blame for unemployment on the Administration. The basic answer is that existing unemployment is mainly the result of the very policies that the labor-union bosses have followed and that the left-wing Democrats want to carry still further.

Unemployment is caused mainly by wage rates that have become excessive in relation to productivity or demand. The price of labor services is like the price of anything else. If it is too high in relation to demand, part of the supply will go unsold. The cure for a commodity is to reduce the price to the point where the entire supply can be sold. The cure in the case of labor is to reduce wage rates, in the lines where they are unworkable, to the levels where full employment can be resumed.

#### ESCALATING WAGES

The policy of the union leaders has been the exact opposite of this. They are constantly pushing wage demands beyond the point of productivity. It is significant that precisely where the unions have been most powerful and most successful—in the automobile and steel industries, for example—recent unemployment has tended to be highest. This is partly because these unions have succeeded in getting automatic escalator clauses in their contracts under which their wage rates rise automatically with increases in the cost of living and also at set periods, regardless of what happens to productivity. Hence even their favorite cure for unemployment—more inflation, a further rise in prices—is now largely ineffective, because automatically escalating wage rates rise even faster than prices and prevent return to workable relationships. Hence we have what the baffled left-wingers call the “paradox” of unemployment with inflation.

The unions keep blaming unemployment on the wrong things, such as “automation.” This is not a cause of net unemployment, but itself partly a consequence of excessive labor costs.

If we look at the remedies for unemployment that the union leaders and left-wingers propose we find that they all consist in various inflationary devices, most of

which would intensify the very evil they are supposed to cure. Increased and prolonged unemployment compensation tends to increase and prolong unemployment. It relieves the pressure on the less conscientious workers to look for or take a new job as soon as possible. It relieves the pressure on the union to readjust wage rates to a level that would permit full employment. It takes the burden of providing for a union's unemployed off the particular unions whose policies have caused it, and throws it on the general taxpayer.

#### AN 'EXTRA BILLION'

This subsidizes the aristocrats of the automobile industry earning an average of \$2.65 *an hour*, or of the steel industry averaging \$3.03 an hour, compared with the average in all manufacturing industry of \$2.19 an hour or of \$1.74 in retail trade.

The belief that the cure for unemployment is a still further increase in wage rates rests on a nebulous "purchasing power" theory. Thus the United Steelworkers of America are running ads implying that a still further wage increase for the steelworkers would somehow bring an "extra billion dollars" into existence. It is not explained where this extra billion dollars would come from—unless an equivalent extra amount of steel were produced. Otherwise whatever added amount the workers got would have to come from the steel companies, and reduce *their* purchasing power for inventories or reinvestment in plant. The most probable result of a further increase in steel wage rates would be to increase steel prices and reduce markets, employment, and "purchasing power."

The Reuthers and McDonalds who most loudly complain about present unemployment are the very people who have done most to bring it about. ❁

## How to Denationalize

April 27, 1959

In the last decade the political appeal of an orthodox socialism—i.e., of government ownership and operation of the means of production—has been fading to the point of disappearance, at least in the U.S. and in Western Europe. Even the parties of the left no longer openly propose further nationalization, but busy themselves chiefly with more "welfare" programs. Yet the nationalization that has already taken place has remained practically undisturbed. It is even carried on, in Britain and elsewhere, by conservative successors of its original socialist sponsors. The prevailing assumption has been that socialization is an irreversible process.

It has remained for Western Germany to find a politically acceptable route to the restoration of private enterprise. A few weeks ago it offered "people's shares" of the capital stock of Preussag A.G., a government-owned mining and machine-building concern, for private subscription. Sales were limited to persons with a taxable income of not more than the equivalent of \$3,800 a year, and each buyer was limited to five shares at the equivalent of \$33 each. The issue was oversubscribed three times. And now the West German Government has begun preparations for the sale, through a similar plan, of the extremely successful government-owned Volkswagen company.

Here is an example that the British, French, Norwegians, Italians, and Spanish, among others, would do well to study and to emulate. The "others" include the citizens of our own country. Let us take two outstanding examples: The New York subways and the Tennessee Valley Authority.

#### NEW YORK SUBWAYS

New York City has operated its own "independent" system since 1932. It bought the rights and properties of the IRT and BMT from the private companies in June 1940. Prior to that time the great issue had been the sanctity of the 5-cent fare. Politicians had made a living by denouncing the "profiteering" and "gouging" of the private companies. But under municipal ownership and operation, the fare jumped from 5 to 15 cents by 1953, an increase of 200 percent. This cannot be blamed solely on "inflation." In the same period the general consumer price index increased by only 91 percent. Even a 15-cent fare now fails to meet municipal-operation expenses. The deficit in the fiscal year ended June 20, 1958, was \$11 million. It is expected to be around \$17 million in the current fiscal year.

These subway deficits have helped to bring about New York City's present fiscal headaches. The issue of private operation has now been revived by the dramatic offer of a group of investors to negotiate for the purchase of the city's entire transit system. The particular terms suggested may not be acceptable, but the re-privatization of the subways is greatly to be desired. The city might well offer "people's shares," with a maximum amount purchasable by any individual, and perhaps a preference to present employees. If any shares remained unsold, the city could open up the rest to free competitive bidding. In any case it would have to give guarantees against imposing fare-controls that would threaten solvency.

#### AND THE TVA

When we turn to the TVA, we find its political champions still pushing for ever more expansion and special



privileges. For the fifth consecutive year, Congress is being asked to authorize the TVA to finance its new requirements for outside capital by issuing revenue bonds to the public. The April survey of the Guaranty Trust Co. of New York points out the dangers of this “blank check” precedent for government agencies. TVA, the bank shows, has always operated under conditions that make a mockery of the “yardstick” idea that was part of the excuse for its origin. “TVA pays no Federal income tax and nothing in lieu thereof. . . . It receives its capital funds from Congress and yet has never paid any interest to the Federal government on any Congressional appropriation. These are not operating economies but special privileges bestowed on the people of one area at the expense of the taxpayers at large.”

It would not be difficult to devise a plan to sell TVA to small investors, perhaps giving prior choice to residents of the territory TVA serves. ❁

## Uncurbed Union Power

May 4, 1959

Congress is now debating a labor bill which is irrelevant to the real crisis in labor today. If enacted in the form in which it came out of the Senate committee, it could only intensify that crisis. For this bill proposes an unpromising method of curbing misuse or embezzlement of union funds by union leaders, and does nothing whatever to curb the privileged monopoly of unions, their resort to intimidation and violence, and their power to paralyze production until their demands are met.

Yet while the great majority in Congress still seem blind to these problems, there has been increasing recognition of them in the academic world. This was evidenced by the appearance two years ago of *The Labor Policy of the Free Society*, by Prof. Sylvester Petro of New York University, and by the appearance a year ago of a symposium, *Labor Unions and Public Policy*, containing contributions by Dean Roscoe Pound, Profs. Edward H. Chamberlin and Philip D. Bradley, and by Gerard D. Reilly.

It is evidenced now by the appearance of two more books. Again one of them is a symposium, *The Public Stake in Union Power*, edited by Philip D. Bradley (University of Virginia Press), and containing lectures delivered at the University of Virginia by sixteen different writers, including such eminent economists as Profs. E.H. Chamberlin, Frank H. Knight, F.A. Hayek, Gottfried Haberler, and David McCord Wright. And again one is a book by Professor Petro,

*Power Unlimited—The Corruption of Union Leadership* (Ronald Press, \$5).

### NAÏVE ASSUMPTION

It would be unfair and impossible to attempt to summarize in this limited space the diverse views of sixteen independent economists. Yet there has obviously been a profound change since the days, 25 years ago, when it was naïvely assumed both in academic and in political circles that labor unions could do no wrong, and that the main if not the sufficient solution of the whole problem was to encourage bigger and stronger unions. As a result the government itself was in effect put into the union-organizing business, and employers were forced to “bargain” with unions set up by government-controlled processes.

Now we find an outstanding economist like Frank H. Knight writing: “‘Bargaining’ is a misleading, essentially dishonest use of a word. . . . What ‘collective bargaining’ obviously means in our case is simply monopolistic action on the part of a labor union. And the union, like any other seller, can secure a price above the free-competitive level only by arbitrarily restricting the quantity offered for sale, obstructing access to work in the union’s jurisdiction.” And F.A. Hayek writes that unions “have become what they are largely in consequence of the grant, by legislation and jurisdiction, of unique privileges which no other association or individuals enjoy. They are the one institution where government has signally failed in its first task, that of preventing coercion of men by other men—and by coercion I do not mean primarily the coercion of employers but the coercion of workers by their fellow workers.”

### MCCLELLAN RECORD

These abstract statements receive overwhelming documentation in the Petro book. Petro has performed the herculean task of working his way through the 40 volumes which make up the record of the McClellan Senate committee, and has arranged, summarized, and interpreted the results. It is an appalling record of corruption and violence, ranging from the embezzlements of the Becks to the mass violence (in the Kohler strike, for example) engineered, authorized, and financed, but piously deplored, by the Reuthers.

Few men are better qualified to summarize this record than Petro, who, though now a professor of law, worked in the steel mills as a youth and took an active part in the CIO’s organization drive in the mid-1930s. In addition to presenting the facts, he has presented his own recommendations for corrective legislation and law enforcement.

If every congressman could be persuaded to read this absorbing and powerful book, Congress would



certainly adopt a vastly different law revision from that proposed in the original Kennedy-Ervin bill. ❁

## Steel Strike Ahead?

May 11, 1959

The Kennedy bill, in the form in which it passed the Senate, would do nothing to mitigate the central labor problem in the United States today. One way to judge how irrelevant it is to that problem is to ask how it affects, if at all, the overhanging threat of a nationwide steel strike.

If ever a strike threat was completely without justification, this one is. Both absolutely and relatively, the steelworkers have made gains far beyond the average. In a January bulletin, the U.S. Department of Labor declared: "According to 1957 gross average hourly earnings data for 318 separate manufacturing industries and groups . . . production workers in the primary iron and steel industry ranked fifth from the top. . . . A study of changes in hourly earnings between 1950 and 1957 reveals that the earnings position of the production worker in primary iron and steel manufacturing improved steadily in relation to that of the average factory worker."

The position of the steelworker has been further improved since 1957. In January 1959 only one industry—flat glass—paid higher earnings than steel. In 1940 the steelworker was already getting 18.3 cents an hour above average earnings in all manufacturing. In January 1959 he was getting \$3.03 an hour—84 cents above. He was also getting 38 cents more than the auto-worker, whom he once trailed. Steel wages have far outpaced the rise in living costs. Since 1940 living costs have increased 106.7 percent; steel wages have increased 259 percent.

### PRICES AND PROFITS

The result has been to force up steel prices. The claim of the steel union that the companies have used the situation to make exorbitant profits is not borne out by the long-term record. In 1958, out of 41 manufacturing industries, steel ranked 27th from the top in its return earned on net assets. Where its rate of profit on sales had been 8.1 percent in both 1940 and 1950, it was only 7.3 percent in 1957 and 6.3 percent in 1958. Without profits in our economic system, there would soon be neither tools, nor production, nor jobs.

Yet the steel unions are threatening to strike when their contract expires on June 30. When, on April 10, the steel companies made a proposal for a one-year

wage freeze, David J. McDonald, the union's president, replied: "I reject it out of hand." One can imagine the political and legal reaction if the companies had made any such retort to a proposal by the union. "Collective bargaining" is still a one-sided requirement.

### LOSSES OF STRIKERS

If a steel strike now does occur, it will probably hurt the steelworkers most of all, whether they "win" or lose. This was the result of the 1956 steel strike. Comparing what they won with what they had been offered without a strike, I pointed out in *Newsweek* of Aug. 13, 1956, that each worker had lost about \$600 as a result of six weeks' idleness; that even at the end of the three-year contract he could make up (assuming a 40-hour week) only \$190 of this, leaving him still \$410 worse off than if he had not struck. I added: "In the long run higher costs of production will . . . mean less employment of steelworkers." This is what happened. In May of 1956, 646,000 men were employed in the steel industry; the number fell to 500,000 in May of 1958.

Yet our Federal laws encourage strikes. Roger M. Blough, chairman of the board of the United States Steel Corp., testified in 1957: "The union has struck our plant five times in the past eleven years. . . . Hardly has one of these strikes begun before there is a nationwide demand that we settle it. . . . And ultimately—if we do not settle—we may face the threat of government intervention, as happened five years ago when the then President of the United States seized our plants illegally and sought to grant the union demands in full."

One factor must be added to this. Because of the attitude of the law and the law-enforcement authorities, no struck steel company today dares to try to carry on its business by hiring workers to replace the strikers. If it did, it is the company, and not the strikers, that would be accused of "provocation" and "violence."

The political cards are stacked in favor of unjustified strikes and inflationary wage increases. ❁

## Giant Step Backward

May 18, 1959

The Kennedy bill, as it passed the Senate, is much worse than no labor bill at all. It would on net balance increase the appalling power of union bosses. And it would do nothing to reform real abuses.

The quickest way to recognize the faults of the bill is to ask ourselves what a sound and balanced labor law would seek to do. It would either not interfere in industrial labor relations at all (as in the days before the Wagner Act), or it would make it illegal for an employer

to require either membership or nonmembership in a union as a condition of employment. The Taft-Hartley Act, like the Wagner Act, piously professes to do this in Section 8a. It declares it an "unfair labor practice for an employer . . . by discrimination in regard to hire or tenure of employment or any term or condition of employment to *encourage or discourage* membership in any labor organization." And then, in flagrant contradiction of this balanced principle, it explicitly authorizes a union shop under which an employer can and must fire a man who does not become a member of a union.

The basic requirement of any sound and balanced labor law would be to legalize beyond the shadow of doubt every practice, including mass picketing, which involves violence, intimidation, or coercion. A guiding principle of labor law should be to protect free employee choice.

### UNION ABUSES

The union abuses that any labor law will have to correct are outlined in all their grisly detail by Prof. Sylvester Petro of the New York University School of Law in his recent book *Power Unlimited—The Corruption of Union Leadership*. The appropriate legal remedies are outlined both in that book and in the same author's *The Labor Policy of the Free Society*.

Let us apply to the Kennedy bill the test of the basic principles just stated. We find that, under the guise of correcting union abuses, it would actually increase the stranglehold of the union bosses. It makes a mockery of the principle of free employee choice. By allowing the building trades unions to fasten a completely closed shop on unwilling workers, it takes an enormous step backward. By prohibiting certain narrowly specified types of organizational picketing, it in effect permits other types of organizational picketing that are probably illegal under present law.

One of the worst features of the new bill is that repealing the present explicit provision of the Taft-Hartley Act which forbids voting by replaced strikers in representation elections. The Kennedy bill would now permit the former employees, who had been replaced by a fair employer as a result of a strike, to vote in an NLRB election. This is like permitting people who have moved out of New York to continue to vote in New York local elections. As some critics have pointed out, this could result in certification of a union not wanted by a single employee on the job. Under this provision the government would in effect throw its support behind every strike, and encourage arrogant abuse of the strike

power. This provision alone throws doubt on the integrity of the whole Kennedy bill.

### WHERE THE BILL FAILS

And the Kennedy bill completely fails to deal with the true causes of union abuses. It gives no protection to employers who are being subjected to shakedowns by racketeers. Its union disclosure requirements add nothing substantial to existing law. Union members already have the right to go to court whenever their officers mistreat them or steal from them. They do not go to court now simply because they are afraid of the physical reprisals which are a favorite technique of unions run by gangsters. The Kennedy bill in no way eliminates the threat of a beating which now intimidates so many union members.

What is chiefly needed today is the repeal of bad labor law—e.g., the Norris-LaGuardia Act. What the Kennedy bill seeks to do is to correct the evils caused by present bad labor law by piling on still more bad labor law, and by interfering still more in the internal affairs of supposedly voluntary associations.

The Kennedy labor bill, if enacted, would be simply one more huge step in the wrong direction. ❁

## The Gold Outflow

May 25, 1959

Last year the United States lost the record amount of \$2.3 billion of gold. The outflow slowed down in the first three months of this year to only \$92 million. But in April and the first two weeks of May it rose to \$197 million for the six weeks.

It is sometimes said that any concern about the present outflow of gold is premature. The reasons given are that, even though the United States gold stock has declined from its peak of \$24.6 billion in 1949 to its present level of \$20.2 billion, this is still a tremendous sum and more than half of all the monetary gold in the world. It is also contended that this loss of gold is actually healthy because it makes for a sounder distribution of gold reserves and strengthens the currencies of other countries.

Any complacency about the situation, however, is unwarranted. Though some \$20 billion is still held in the United States, it is not, strictly speaking, owned by the United States. The "free" gold supply is comparatively small. The notes and deposits of the Federal Reserve Banks are required by law to be backed by 25 percent of gold. As of May 6, this called for a gold cover

of \$11.7 billion, leaving the Treasury with only \$8.5 billion of “free” monetary gold.

(It is also instructive to recall that if Congress had not reduced the reserve requirements to only 25 percent as a “war” measure in 1945, and had kept the previous requirements of 35 percent gold reserve against deposits and 40 percent against notes, the amount of “free” gold today would be only \$2.5 billion.)

### WHAT THE THREAT IS

As against the Treasury gold holdings, banks in the United States already have short-term liabilities to foreigners totaling \$16.6 billion. So if foreigners really elected to withdraw their deposits and short-term assets in gold, and could do so through their central banks, the situation would become very serious.

One of the explanations most frequently offered for the loss of United States gold in the last sixteen months is a “deficit in the balance of payments with the rest of the world.” This explanation confuses cause and effect, and suggests the wrong remedies. The chief reason for the outflow of gold is distrust of the future of the American dollar, brought about by our inflationary policies. These policies also cause the deficit in the balance of payments. Unless we have the sense and courage to halt these inflationary policies in time, the withdrawal of gold could become accelerative.

### FOUR POSSIBLE STEPS

Discussing this subject in *Newsweek* of Dec. 22, 1958, I listed a few specific steps we should consider to restore confidence in the dollar. I repeat the substance of them here, with some change in emphasis and detail:

1—The Federal Reserve Board should definitely abandon the effort to make money artificially cheap by open-market purchases, further reduction in reserve requirements, and similar measures. Firm interest rates will not only discourage the withdrawal of foreign balances but stop encouragement to credit expansion.

2—The Administration and Congress should take dramatic steps toward slashing the deficit and balancing or even overbalancing the budget. They should do this not by increasing taxes still further (which would only act as a deterrent to production) but by slashing unjustified expenditures. Swollen veterans’ aid and the whole farm subsidy and price-support program are obvious candidates for the ax.

3—It makes no sense to continue and even to expand an enormous foreign-aid program when our problem is already inflation, excessive government spending, the loss of gold to foreigners, and a deficit in the balance of payments. Our military-aid program should be much more selective. Our economic-aid program, which rests on dubious socialistic assumptions,

should be discontinued. Particularly ill-timed is the pending subscription of some \$1.3 billion by our government to the International Monetary Fund, which operates on questionable monetary assumptions.

4—Revise the Federal legislation and NLRB decisions that enable labor leaders to force excessive wage rates on employers and tend to price our products out of world markets. ❁

## Communist Strategy

June 1, 1959

We got into the Foreign Ministers’ meeting at Geneva, and into all the plans for a “summit conference,” by yielding to Soviet propaganda and pressure. There never has been any sincere desire in Moscow for “peaceful coexistence” or for a just “settlement.” “Negotiation,” to them, is merely a technique of warfare. They want the West to negotiate its own surrender—or, failing that, to make concessions that will further weaken its military or moral position. At the very least they want a conference to give them a world loudspeaker for their propaganda against the West.

We have been lured into these conferences by not knowing how to get out of them. How can we refuse to “negotiate” for peace? But the question confuses means with ends. The goal is peace with justice. A summit conference, or even a Foreign Ministers’ conference, is at best a means. Both means are unpromising for the West. Neither is necessary. The West could have said long ago, and there is time to say still; that if Khrushchev has any proposals for a Berlin, a German, or any other settlement to make to us, our Ambassadors in Moscow are always there to hear them, to transmit them, to negotiate concerning them. This in fact is the precise reason why our Ambassadors and their staffs are there.

### AMBASSADORIAL LEVEL

If the Foreign Ministers’ conference fails, therefore, we could keep the door open, instead of passing the problem on to a futile summit conference, by suggesting that the negotiations be continued quietly at the ambassadorial level. This is the chief *raison d’être* for the whole traditional ambassadorial system. If it is to be bypassed every time matters of importance arise, it becomes an expensive farce.

At a press conference on May 5, President Eisenhower seemed to minimize what the forthcoming Foreign Ministers’ meeting could achieve by saying: “All of us do know that within the Soviet regime there is only one man who can talk authoritatively.” But



the fact that the consent of a head of state is necessary for final ratification of an agreement need not mean that all negotiations must be with him directly, and by other heads of state. The very day before the President said this, our Ambassador at Moscow had presented to Khrushchev a demand for information on eleven American fliers, missing since the crash of a C-130 transport in Soviet Armenia last September. This is the proper procedure. If it is not effective, it is because the head of state does not really want a settlement.

### FEAST—OR FAMINE?

These thoughts are suggested by an important book that has just appeared under the auspices of the Foreign Policy Research Institute at the University of Pennsylvania—*Protracted Conflict*, by Robert Strausz-Hupe, W.R. Kintner, J.E. Dougherty, and A.J. Cottrell (Harper, \$3.95). The book is the most acute study of Communist international strategy that I have yet seen. It describes in detail the political, economic, psychological, and military techniques that the Communists have been using against the West since 1945, as well as the sporadic, halfhearted, and purely defensive responses of the Western democracies. There are separate chapters on the Soviet's "Monopoly of the Initiative" and on their strategy of "Deception and Distraction." And one of the devices of deception treated is the "deliberate falsification of economic data."

This continues to be successful because gullible Westerners continue to play into the Communists' hands. Even within the last two weeks Lord Boyd Orr, for example, speaking from Moscow, endorsed the extravagant claims of the Chinese Communists by saying that they appeared to have raised food production by "50 to 100 percent" in three years. Yet three days after that estimate, a dispatch from Hong Kong in *The New York Times* reported that "residents of Shanghai have been unable to get bread of any kind for two and a half months," while "the rice lines in all large cities were increasing steadily in size and rations were decreasing."

Those who are so ready to give credence to Communist lies about production betray a weak faith in our free economic system. ❁

## The First Step

June 8, 1959

The hospital strike in New York City threw a brilliant light on what is basically wrong with our labor law and law enforcement. Hospitals, it is true, are exempt from the labor-law provisions that apply to profit-making

business. They are not forced to bargain with a particular union. They are free to apply for an injunction against mass picketing. The besieged New York hospitals did apply for injunctive relief and were granted injunctions by courts in Manhattan and Brooklyn. But mass picketing nonetheless continued. The mayor and police of New York were slow to enforce the injunctions.

The situation exposed the absurdity of the slogan, dear to muddleheaded "liberals," that one must never pass a picket line. Let us hope that for the peace of their souls none of these people had seriously ill friends or relatives who were patients at any of the hospitals affected.

But the incident also serves to expose the hollowness and irrelevance of the Kennedy bill passed by the Senate. That bill is now opposed by labor-union leaders on the ground that it interferes in detail in the internal affairs of ostensibly voluntary organizations. This is a proper ground for opposition. But a far more serious reason is that the Kennedy bill and its sponsors remain completely blind to what is fundamentally wrong in our labor law. This is that it permits violence, intimidation, and lawlessness.

### NEED FOR REPEAL

What is needed is not more Federal labor legislation but less. What is needed is repeal—above all repeal of the Norris-LaGuardia Act.

Few people realize what this law really does. It is commonly believed that it merely prevents the Federal courts from enjoining "strikes." But the right of workers peaceably to quit work, and even to do so collusively, was not denied by the Federal courts prior to the enactment of the Norris-LaGuardia Act. What the courts had been enjoining, in the words of Prof. Sylvester Petro, was "the violent, intimidatory, coercive activity of trade unions, not strikes for higher wages and better working conditions."

The Federal courts had enjoined only unlawful conduct which threatened irreparable harm. But in the Norris-LaGuardia Act of 1932, Congress, instead of defining boundaries for union conduct, chose to make practically all union conduct unenjoinable. To prohibit Federal judges from issuing labor injunctions, on the assumption that they cannot be trusted to act impartially, is an insult to the integrity of our courts. It implies distrust of the judicial system itself.

### PICKETING AS COERCION

The evil begun by Congress has been compounded by the "new" Supreme Court. During the past twenty years it has provided a succession of additional privileges for aggressive union action. Until recently, it even identified the coercive economic weapon of picketing with



“freedom of speech.” Under such reasoning, the United Automobile Workers were simply exercising “freedom of speech.” when they set up a line of 2,000 pickets around the Kohler plant, forming a human barricade, making entrance to the plant impossible, and harassing, assaulting, and humiliating nonstrikers.

Where the Norris-LaGuardia Act bars employers and nonunion employees from going to the Federal courts for immediate relief from irreparable injury, the Supreme Court’s more recent pre-emption doctrine even bars them from going to the state courts. Chief Counsel Kennedy and some members of the McClellan committee heaped scorn as well as direct accusations of impropriety upon employers who had yielded to shake-downs. Yet it is Congress itself that has made it impossible for the victims of trade-union wrongdoing to secure any help from the law.

The primary need is to restore the principle that every man who feels himself aggrieved by unlawful conduct has a right to a day in court. And local officials, instead of courting the so-called “labor vote,” must have the courage to enforce the laws and judicial decisions against violence or intimidation.

It is because it is completely oblivious of such primary needs that the Kennedy bill would be a mockery of labor-law reform. ❁

## The Open Conspiracy

June 15, 1959

Thirty years ago—in 1928, to be precise—H.G. Wells published a minor propagandistic novel called *The Open Conspiracy*. Though I reviewed it at the time, I’ve forgotten now exactly what that open conspiracy was. But the description seems to fit with peculiar aptness something that is happening in the United States today. Our politicians, and most of our commentators, seem to be engaged in an open conspiracy not to pay the national debt—certainly not in dollars of the same purchasing power that were borrowed, and apparently not even in dollars of the present purchasing power.

There is of course no explicit avowal of this intention. The conspiracy is, rather, a conspiracy of silence. Very few of us even mention the problem of substantially reducing the national debt. The most that even the conservatives dare to ask for is that we stop piling up deficits so that we do not have to increase the debt and raise the debt ceiling still further. But anyone with a serious intention of eventually paying off the national debt would have to advocate overbalancing the budget, year in, year out, by a sizable annual sum.

Today one never sees this problem seriously discussed. We see hundreds of articles and hear hundreds of speeches in which we are told how we can or should increase Federal expenditures or Federal tax revenues in proportion to the increase in our “gross national product.” But I have never seen an article that discusses how we could begin and increase an annual repayment of the debt in proportion to the increase in our gross national product.

### 285 YEARS TO PAY

When we look at the dimensions the problem has now assumed, it is not difficult to understand the somber silence about it. If someone were to propose that the debt be paid off at an annual rate of \$1 billion a year, he would have to face the fact that at that rate it would take 285 years, or nearly three centuries, to get rid of it. Yet \$1 billion a year is even now no trivial sum. Republican Administrations, after World War I, did succeed in maintaining something close to such a steady annual rate of reduction between 1919 and 1930; but they were under continual fire for such a “deflationary” policy. Because of such deflationary fears, one would hardly dare mention a higher rate today.

One suspects that there is at the back of the minds of many of the politicians and commentators who sense the dimensions of the problem an unavowed belief or wish. This is that a continuance of inflation will scale down the real burden of the debt in relation to the national income by a constant shrinkage in the value of the dollar, so reducing the problem to “manageable proportions.” Such a policy would be indignantly disavowed. But this is precisely what our reckless spending is leading to. On the debt we contracted twenty years ago we are paying interest and principal in 48-cent dollars. Are our politicians hoping to swindle government creditors by paying them off in dollars twenty years from now at less than half the purchasing power of the dollar today?

### A ‘JUGGLING TRICK’

This trick, alas, has a long and inglorious history. “When national debts have once been accumulated to a certain degree,” wrote Adam Smith in *The Wealth of Nations* in 1776, “there is scarce, I believe, a single instance of their having been fairly and completely paid. The liberation of the public revenue, if it has been brought about at all, has always been brought about by a bankruptcy; sometimes by an avowed one, but always by a real one, though frequently by a pretended payment [i.e., payment in an inflated or depreciated monetary unit]. . . . The honor of a state is surely very poorly provided for, when, in order to cover the disgrace of a real bankruptcy, it has recourse

to a juggling trick of this kind, so easily seen through, and at the same time so extremely pernicious.”

Our government is not forced to resort, once more, to such a “juggling trick.” It is not too late for it to face its responsibilities now, and to adopt a long-term program that would eventually pay off its creditors with at least the present 48-cent dollar, without plunging us further into inflation or deflation. ❁

## The Egg in Politics

June 22, 1959

A crisis has developed among the poultry farmers, the result of a huge overproduction of eggs. Eggs have been selling in recent months below their cost of production for most small farmers. The result, as usual, has been pressure on the government to “solve” the problem, and the Department of Agriculture has been forced to promise to step up its egg-buying program. It has already bought some 500 million eggs, dried or frozen, and perhaps the race has just begun.

Of course the effect of this program, to the extent that it is “adequate,” can only be to encourage continuance of overproduction. Without this government buying, adjustments would soon set in to bring the overproduction to a halt. But, at least as far as farmers are concerned, most politicians consider the adjustments brought about by supply and demand as too callous and cruel; every farmer must at all costs be protected from them. The congressmen who take this view do not see that what they are refusing to accept is the whole principle of the free market, which is the central principle of free enterprise.

### WHAT FREE MARKETS DO

It is the principle of the free market that regulates the relative price and production of thousands of different commodities to meet the relative wants and consumption of millions of consumers. When there is too little of a desired commodity, the demands of consumers will lift its price relative to other commodities; and more of that commodity will be produced because of the higher profit margin, until the price falls again. When there is too much of a commodity, its price will fall below the previous marginal cost of production, and the highest-cost or least-efficient producers will have to turn to something else.

This sometimes means great hardship for the individuals affected. But this finely graduated system of rewards and penalties, of incentives and deterrents,

leads in the long run to the greatest production, growth, and general welfare provided by any economic system. And this same system, which politicians think “intolerable” as applied to farmers, is in fact accepted in nearly all other fields. The annual figures of industrial failures are a constant reminder. Government studies have shown, to cite only one statistic, that only three-fifths of firms in retail trade survive their first year, and only a sixth reach the age of ten years.

The practice of price support must involve favoritism. It simply cannot be universalized. We cannot subsidize everybody at the expense of everybody else. One of the very things that the egg farmers are chiefly suffering from, in fact, is the price supports and subsidies to the grain producers. These have raised the price that poultry raisers are forced to pay for feed. Nothing could help the egg farmers more than the termination of price supports on grain.

### FIASCO IN WHEAT

The price-support program in wheat grows more and more fantastic. In a statement on June 1, President Eisenhower pointed out that the existing program had piled up \$3 billion worth of wheat, a supply equal to two and a half times our annual domestic needs; that storage, handling, and interest charges alone for this wheat will cost the American taxpayers close to half a billion dollars during the next fiscal year, and that “continuation of this legislation for another year leads the wheat program one step closer to disaster.”

These programs, which increase the price of feed for cattle and poultry raisers, and the price of food for city workers, are costing the taxpayers some \$6 billion a year. Grain farmers are growing crops for government storage rather than for markets. *The Wall Street Journal* reports that some farmers are even deliberately growing inferior-quality wheat in order to take advantage of the government’s generosity.

Secretary Benson’s proposed solution is to reduce the price support to 90 percent of the average market price for the three years preceding the crop year. This would certainly reduce the dimensions of the problem. But any price support at all, to the extent that it is effective, must encourage excess production and storage. Today’s “farm problem” is government-created. ❁

## The Interest Ceiling

June 29, 1959

The President, the Secretary of the Treasury, and the chairman of the Federal Reserve Board are all urging Congress to remove the present legislative ceiling of

4¼ percent on the interest rate that the government can pay on its new issues of bonds with a maturity of five years or more. The reform is urgent. Some long-term Treasury bonds have already been selling in the open market at prices that yield about 4½ percent. The government cannot sell new long-term bonds at yields below going market rates. The only effect of the present limit is to force the government to finance its needs through short-term borrowing. But this merely drives up rates (on which Congress has been wise enough not to put any ceiling) on short-term borrowing, and forces the government to keep coming back to an uncertain market every few months.

Some of the Democrats in Congress have been cool to the suggestion that the rate ceiling on long-term bonds be removed. They are full of counter-proposals, typical of which is that the Federal Reserve System support or buy in long-term government bonds at prices that would keep their yields 4¼ percent or below. Such proposals would not only destroy once more the hard won independence of the Federal Reserve Board, but they would be violently inflationary.

#### HOW INFLATION COMES

The Federal Reserve System was forced to peg the government bond market through the second world war and until early in 1951. One result was a huge inflation. As Secretary Anderson explained the process anew in his recent testimony: The Reserve banks would buy Treasury securities, paying for them by creating deposits in the Treasury's name. As the Treasury paid out this money to individuals, the Treasury checks would be deposited in individual banks, thus adding to those banks' reserves because such checks are the equivalent of cash. This increase in the banks' reserves would provide for a multiple addition to the banks' lending and investing power. Direct sale of Treasury issues to the Federal Reserve, in short, would "provide the basis for a highly inflationary expansion of the money supply."

The purchase of government securities by the Federal Reserve System is inflationary even when it buys short-term securities. But the situation would be much worse if it supported long-term securities also. Federal Reserve economists have pointed out that when the system buys, say, three-month bills, longer maturities are also affected in at least some degree by substitution or arbitrage transactions. In any case, increased bank reserves, which increase by a multiple factor the supply of funds available for loans and investments, are provided just as effectively by operations in bills as by operations in bonds. And there is a further consideration. The purchase of long-term bonds might have to be endless and astronomical to hold down the

long-term interest rate. Such bond purchase, therefore, would ultimately be enormously more inflationary than bill purchase.

#### A FALSE 'SAVING'

Some congressmen honestly think they are saving the taxpayers' money by forbidding higher interest payments on government bonds. But the inflation they would force through Federal Reserve buying to keep down the bond yields means, as the President has put it, that "the additional cost to the government alone for increased prices of the goods and services it must buy might far exceed any interest saving."

The irony is that the very congressmen who are now complaining about higher interest costs for the government are among those who have done most to bring them about. By insisting on artificially cheap money in the past, they increased the present extent of inflation. Part of the interest rate that the government must now pay for long-term borrowing is in effect an insurance premium that lenders are asking as a hedge against further depreciation of the dollar.

The chief contribution that Congress can now make is to balance the budget, remove fears of further inflation, stop agitating for cheap money, and let the Treasury meet whatever competitive rate is necessary to sell its bonds. ☼

## The Strauss Aftermath

July 6, 1959

The consequences of the Senate's rejection of the nomination of Lewis L. Strauss as Secretary of Commerce will be felt for a long time—and few of them seem likely to be good.

Strauss was eminently qualified for the position. Few of his predecessors in the office, indeed, have had equal qualifications. These were revealed in the eight months he had served as Secretary and in his previous long record of public service. As Arthur Krock summed up the case in *The New York Times*, the rejection of his nomination "marks a Senate repudiation of the type of highly talented, self-sacrificing citizen that it has become increasingly difficult for Presidents to recruit for government service except in time of war. [Strauss] had served and been commended by four Presidents, awarded five of the highest national decorations, was an officer in the Naval Reserve who rose to rear admiral, and who, as he vastly understated it in his comment on his rejection, had 'done the best I knew how to do to protect and defend the national security when that



was not the recognized, nor easy, nor popular course of action at the time' (the decision to produce the H bomb)."

Yet Strauss was the first Cabinet appointee to be rejected by the Senate in 34 years, and only the eighth such rejection in our history.

### THE REASONS FOR IT

When one seeks the reasons for this, the last place one finds them is in the explanations most frequently offered. We are told that he had grave personality faults. For example, when he was violently attacked, he defended himself! When he was accused of all sorts of wrongdoing, he refused to admit it! This proved his "arrogance." Also, the Administration was accused of "lobbying." That is to say, when Strauss's enemies in the Senate resorted to personal vituperation, almost daily calling him a "liar," Administration supporters had the impudence to put in a quiet word in his behalf! We were told at the same time that the senators who voted against him did so because his answers were "evasive and unresponsive," and because he insisted on replying to every charge. He further infuriated his questioners by bringing in documents that disproved their charges.

Suppose we look at the real reasons for Strauss's rejection, most of which were not hidden.

The first is that he really stood for private enterprise, and had the courage to try to slow down the steady expansion of the socialized and subsidized public-power empire represented by the Tennessee Valley Authority. He had continued to stress private rather than public development of nuclear power.

### SOME CONSEQUENCES

The second is that Strauss was too aggressively and persistently anti-Communist. The Senate committee that passed on the nomination listened to a delegation from the Federation of American Scientists. These gentlemen complained that Strauss had been responsible for the dismissal of J. Robert Oppenheimer; had urged construction of the H bomb; had favored restrictions on the dissemination of scientific secrets, and had opposed suspension of bomb testing.

The third reason for Strauss's rejection is that Democrats in Congress, playing the most petty type of partisan politics, wanted to "rebuke" the President and show that "the veto can work both ways."

The action of the Senate majority was vindictive and irresponsible. By repudiating the President's nominee, they violated the long-standing tradition that a President should be free to choose the members of his official family. They have weakened the President's prestige in foreign negotiations at a time when it is imperative to strengthen it. They have discouraged men of dignity and stature from accepting

nominations to Cabinet posts that may subject them to the insult and vituperation that was poured upon Mrs. Luce and Admiral Strauss. They have shown that they will punish nominees who are in favor of private enterprise rather than socialized enterprise; who are hesitant about releasing defense secrets; who have the courage to remove security risks; or who take a leading part in developing weapons, like the hydrogen bomb, that constitute our greatest source of national security. ❁

## Saving Is the Key

July 13, 1959

For 25 years the Western world, and particularly Washington, has been dominated by the economic philosophy of *The General Theory of Employment, Interest, and Money* by John Maynard Keynes. That philosophy, as commonly interpreted, supports a program of deficit financing and inflation, of ever-rising money wages (never to be adjusted downward) and of low interest rates under all conditions. Above all the Keynesian philosophy deplores saving, which it calls hoarding or "liquidity preference," and blames as the primary cause of slumps.

In my book *The Failure of the 'New Economics'* (Van Nostrand, \$7.50), I examine the *General Theory* chapter by chapter and theorem by theorem, calling attention to its many fallacies, contradictions, and errors of fact. But Keynes's own book might never have been written if he had devoted some of his days and nights to a careful study of the Austrian economist Eugen von Böhm-Bawerk (1851–1914).

Böhm-Bawerk's two volumes on *Capital and Interest* had been published respectively in 1884 and 1889. English translations by William Smart appeared respectively in 1890 and 1891. But Böhm-Bawerk subsequently made extensive revisions and additions, and published second and third editions, also adding a third volume, over the following 25 years. These were never translated. English-reading economists based their interpretation of Böhm-Bawerk, at best, on the Smart translation. Now, however, a new translation has appeared, by George D. Huncke and Hans F. Sennholz, of the whole three volumes of the fourth (posthumous) Austrian edition of 1921 (Libertarian Press, South Holland, Ill., \$25).

### CAPITAL AND INTEREST

Böhm-Bawerk made greater contributions to the theory of capital and interest than any other economist. Knut Wicksell called *The Positive Theory of Capital* (the second volume) "one of the finest achievements of economic



theory.” It would be impossible, of course, to review or summarize here these three volumes of more than 1,200 closely packed pages. But Böhm-Bawerk’s name is most closely associated with one doctrine that “a wisely chosen selection or extension of a roundabout way of production generally results in greater productivity.”

Keynes’s knowledge and criticism of Böhm-Bawerk seem to have been taken at second hand from Alfred Marshall: “It is true,” wrote Keynes in the *General Theory*, “that some lengthy or roundabout processes are physically efficient. But so are some short processes. Lengthy processes are not physically efficient because they are long.” But this was explicitly and emphatically conceded by Böhm-Bawerk himself: “Above all, my thesis does not state that *every* lengthening of every production process must literally and without exception lead to higher productivity or that a process must be more productive just because it is more time-consuming, even if it has been blindly or impractically chosen.” In short, more time-consuming roundabout ways of production are chosen, *in spite* of the fact that they are more time-consuming and round about, because they are also more productive, and hence in the long run more economical.

### CAPITAL FORMATION

Keynes might have gained even more from a study of Böhm-Bawerk. He might have been brought to recognize the fallacies in his own fear of saving. “Economic growth,” higher real wages and living standards, are possible only through new capital formation. The rate of economic growth depends on the rate of capital formation. “Production and saving,” as Böhm-Bawerk pointed out, “constitute equally indispensable conditions of the formation of capital.”

This is what Keynes tended constantly to overlook. He persistently regarded saving as something merely negative, a mere non-spending. And here Böhm-Bawerk could have reminded him: “To complete the act of forming capital it is of course necessary to complement the negative factor of saving with the positive factor of devoting the thing saved to a productive purpose. . . . [But] saving is an indispensable condition precedent to the formation of capital.” ❁

## Portrait of Russia?

July 20, 1959

A visit to the Soviet exhibition at the New York Coliseum raises more questions than it answers. A visitor sees, for example, a Russian-made automobile.

But what does this tell him about the comparative state of the Russian and American motor industries? What does the Russian car cost to produce? How does it run? Is it actually in mass production? How many are turned out? How many Russians could afford one?

American automobile engineers tell us that the Chaika, for example (a car made only for officials), is not mass-produced, that there is no original engineering in it, that the Russian designers are imitating even our mistakes. But most of the questions above are questions that even an American engineer cannot answer. A better expert is someone who has lived in Russia. Max Frankel, who spent two years in the Soviet Union as correspondent for *The New York Times*, tells us that a visitor to the Russian show can see far more there in two hours than he was able to see in his two years in Russia—“far more especially of the stuff of Soviet wishful dreams.”

### IMAGE OF ABUNDANCE

“The products and models at the exposition are a distinct surprise to someone who works and travels in the Soviet Union. . . . The Soviet exhibition strives for an image of abundance with an apartment that few Russians enjoy, with clothes and furs that are rarely seen on Moscow streets, and with endless variations of television, radio, and recording equipment, cameras and binoculars that are not easily obtained in such quality or range in Soviet stores. . . . The men and women employed as guides have been hastily dressed in American suits and dresses and shoes. . . .

“The restraint in showing toys and drugs and household goods reflects the low priorities assigned to such goods in the Soviet Union. . . . The large, sleek Packard-like limousine Zil is produced exclusively for chauffeured government duty. The small Moskvich advertized as an ‘economy’ car would cost a Russian worker at least a year’s wages and many years of patient waiting. . . .

“The majority of Russian city folk must still live in communal apartments, four and more to a room, sharing bathroom and kitchen with two and more families. . . . Few Russians enjoy built-in kitchen cabinets like those in the model apartment. A few similar sets caused a sensation in Moscow last year when imported from Finland. . . . Shower curtains are hard to find. . . .

“A visit to the Soviet Union exposes glaring paradoxes of ugly slums and palatial subways, muddy roads and huge jet planes. These contrasts are glossed over at the Coliseum.”

### REAL FACTS ON OUTPUT

To those who have followed factual studies of the Russian economy there should be nothing surprising

in this report. In *Newsweek* of May 27, 1957, I discussed the careful study of Prof. G. Warren Nutter covering 37 leading industries, from which he concluded that "Soviet industry still seems to be roughly three and a half decades behind us in levels of output and about five and a half decades in levels of per capita output." More recent studies have shown that in Russia there is one agricultural worker for every 10 sown acres as against one for every 60 sown acres in the U.S. Yet Russia produces only a third as much meat and half as much grain per capita as the U.S. The Russian occupies less than a fifth as much dwelling space as an American. Most families have only a single room in which all members sleep.

These facts reveal how ludicrous are the Russian claims that they are about to equal or surpass us in "peaceful production" or living standards for their people. In this respect they are still enormously behind not only the U.S. but nearly every country in Western Europe. But we should carefully distinguish between production for peace and production for war. In the latter Russia has made giant technological strides—precisely because she has put that goal first.

And in propaganda she is enormously our superior. She can put on an exhibition that gives false impressions of merit, whereas our own exhibition at Brussels exhibited and apologized for our slums, and the new one at Moscow will have a painting lampooning our generals. ☼

## Why a Steel Strike?

July 27, 1959

Whom does a steel strike hurt? It hurts, of course, the companies against which it is ostensibly directed. When forced to suspend operations, they must face losses instead of profits. And if they are forced to settle at higher labor costs, these must either squeeze or wipe out profit margins, or force the companies to charge higher prices for their steel. This, in turn (except as it may be offset by a new round of monetary inflation), must shrink markets and volume of sales.

A steel strike hurts the whole country. For the nation produces less steel, not only during but perhaps after the strike. It loses export markets, and even part of its domestic market, to foreign producers of steel. This slows down the long-term growth of a key defense industry.

A steel strike hurts workers in other industries. During the strike many of these workers are laid off, because of shortage of raw or semi-finished steel. If

the strike is settled by an uneconomic wage rise, these other domestic industries suffer through an increase in their costs.

### THE 1956 RESULTS

What, finally, of the steelworkers themselves? During the strike, they are hurt worst of all. Their wage income is totally cut off, and they do not know when it will resume again.

The results of the 1956 steel strike are instructive. Comparing what the steelworkers had won with what they had been offered without a strike, I pointed out in *Newsweek* of Aug. 13, 1956, that each worker had lost about \$600 in wages as a result of an average of six weeks' idleness; that even at the end of the three-year contract he won he could make up (assuming a 40-hour week) only \$190 of this, leaving him still \$410 worse off than if he had not struck. I added: "In the long run higher costs of production will . . . mean less employment of steel workers." This is what happened. In May of 1956, 646,000 men were employed in the steel industry; the number fell to 500,000 in May of 1958. Though it increased in the first half of this year (mainly to fill orders in anticipation of a strike) the net loss to the whole body of steelworkers is clear.

Why, then, another steel strike?

Who wanted it, and why? One answer might be framed in terms of the psychology of a single man—David J. McDonald, the president of the steel union. He had made such sweeping demands that he could not back down without losing face.

### UNION IDEOLOGY

But this view is too narrow. The psychology of McDonald must be viewed in a wider setting. Each union leader seeks to show that he can get more for his union, relatively or absolutely, than other leaders get for theirs. It has come to be the established expectation of each of the major unions that every year, and above all at every new contract, there must be a substantial increase in wage rates, beyond any rise in living costs no matter what level wage rates have already reached.

Hence the mere fact that steel wages in the last twenty years have increased both relatively and absolutely more than almost all other wages, and that they stood just before the strike at \$3.10 an hour compared with an average of \$2.23 an hour in all manufacturing industries, was considered no argument against a still further increase now. Nor was the fact that the American steel industry, on important items, was already being priced out of foreign markets.

For it is part of current union ideology that wages are not determined by marginal labor productivity but by tough "bargaining"; that increases are not the result

of competitive demands of employers for workers but of strike threats. Another item in this ideology is that an increase of wages for one group of workers helps all other groups. This is the doctrine of labor "solidarity." The truth is that any increase of wages for the workers in any line that goes beyond the point justified by marginal labor productivity is at the expense of the workers who must be laid off as well as of the living costs of all other workers.

And union ideology is reflected in our labor law, which confers exclusive bargaining powers, sanctions compulsory unionism, and tolerates mass picketing. So a word from the head of a single union can bring a national industry to a halt overnight. ❁

## On Not 'Interfering'

August 3, 1959

President Eisenhower has said that he will not interfere in the steel strike at this stage. And certainly he has not interfered in the sense, for example, that Mr. Truman interfered when he seized the companies in 1952 and tried to impose big wage increases on them. Mr. Eisenhower is ostensibly following a "hands-off" policy, to permit "free voluntary collective bargaining." Yet the Federal government has been in fact interfering, and interfering every day, on the side of the union leaders and of greatly increasing the effectiveness and coercive power of a strike. It is interfering through the Federal labor laws already on the books (with the help of lack of local law enforcement against union coercion and violence).

The Norris-LaGuardia Act, for example, in effect prevents employers or nonunion employees from going to the Federal courts for immediate relief from irreparable injury. Mass picketing is tolerated, and has proved in fact so intimidatory that the steel companies have not even attempted to carry on production in any of the six national steel strikes that have been called since the end of World War II. As one news item matter-of-factly put it a few days ago: "Any 'back-to-work' drive under company sponsorship would touch off picket-line violence of a type that has been unknown in the steel industry since the strikes of twenty years ago." Even in the present strike, picket lines stranded an estimated 500 supervisors in three Jones & Laughlin plants. The stranded personnel was made up of a stand-by corps to prevent deterioration of equipment, maintain essential utilities, and keep a fire watch.

## COMPULSORY BARGAINING

Government interference, in fact, began long before the strike. The phrase "free voluntary collective bargaining" has become a mockery. The employer's "bargaining" is neither free nor voluntary. He is compelled by law to "recognize" and "bargain with" one specific union. No matter how unreasonable the demands of that union may be, he is forbidden to deal with anybody else with whom he might make a more acceptable voluntary agreement. This is a discrimination that the law does not make in favor of any other private group. It supplies corrupt or ruthless labor leaders with a weapon of extortion and shakedowns. Moreover, an officially "recognized" union, though it may originally have represented only 51 percent of a given group of employees, is legally granted *exclusive* bargaining rights for that group. This means that dissenting individuals or minority unions are *denied* the right of freely bargaining for themselves.

## ONE MAN'S POWER

And so it comes about that one man, one private individual, has the power to bring practically the entire steel industry to a halt overnight. And other single individuals can bring the automobile industry, or the coal industry, or the aluminum industry, or the railroads, or the airlines to a halt. And then the country is helpless. There seems no way of ending the paralysis except by forcing the employers to give in, to grant the union demands, so that union leaders will permit us to start producing steel or aluminum or coal again. No way is even contemplated of resuming production without their consent.

The government's impotence, of course, is of its own making. But what, meanwhile, does Congress do? It acts as if the whole situation did not exist. It is now tinkering with a labor bill that deals with none of the primary or central problems, but only with secondary and peripheral problems; and even for most of these it proposes the wrong remedies. Congress acts as if there were only one problem—the corruption of some labor-union bosses, or their excessive power over rank-and-file members. Any injustice or harm to nonunion employees, or to employers, or to the public is treated either as if it did not exist or as if it did not matter—as if nobody but union members had any rights that anyone was bound to respect.

This is the ideology behind present Federal law and its discussion. It forgets, finally, that industrywide unions cannot raise wages by coercive strikes except at the cost of bringing on either unemployment or additional inflation. The steel union did both by its strike in 1956. ❁



## Ordering Inflation

August 10, 1959

The Democratic majority in Congress has been playing transparent politics with the nation's fiscal and monetary system. The effect of the policies it advocates would be to let loose a more dangerous inflation than any the country has yet experienced.

On June 8 the President requested Congress to eliminate the  $4\frac{1}{4}$  percent legal limit on rates the Treasury may pay on new issues of bonds with a maturity of more than five years. As a result of the rise in interest rates, the Treasury can no longer count on selling long-term bonds below this rate.

After pondering a full month, the House Ways and Means Committee, on July 8, instead of simply removing a legislative ceiling that should never have been there at all, gave the President, as a sort of favor, the right, for not more than two years, to disregard the interest-rate ceiling when he found higher rates necessary "in the national interest." The obvious political intent of this was to try to make the President seem personally responsible for paying any higher rate that market conditions might make necessary. The Democrats went even farther. An amendment to the proposed authorization read:

### DOUBLE-SPEAK

"It is the sense of Congress that the Federal Reserve, while pursuing its primary mission of administering a sound monetary policy, should to the maximum extent consistent therewith utilize such means as will assist in the economical and efficient management of the public debt, and that the system, where practicable, should bring about needed future monetary expansion by purchases of U.S. securities of varying maturities."

Here was a beautiful specimen of double-speak. The Federal Reserve System was to bring about more inflation by monetizing the public debt, short-term or long-term, but to do this only to the "extent consistent" with "sound monetary policy." It was to give us inflation and sound money at the same time.

When the Federal Reserve and the Treasury objected to the inflationary implications of this, Sam Rayburn, Speaker of the House, angrily declared that the Federal Reserve authorities considered themselves "immune to any direction or suggestion by the Congress, let alone a simple expression of the sense of Congress."

There are several issues involved here. The first is whether the provisions of the measure approved by the House Ways and Means Committee are inflationary. To this there is only one answer: They certainly are. They would put pressure on the Treasury to continue

with short-term rather than long-term financing. They would put pressure on the Federal Reserve to expand the currency by monetizing the debt. Both proposals, it is obvious, would be inflationary.

### BAD REFUNDING

True, our debt management record since the end of World War II is not one of which successive Secretaries of the Treasury can feel very proud. At practically any time up to 1956 the Treasury could have funded the debt in long-term bonds at 3 percent or less. It kept failing to do so because short-term rates (largely as a result of inflationary Federal Reserve policies) were lower still, sometimes falling to  $5/8$  percent. The Treasury acted as if this situation would last forever. It kept missing opportunities because it assumed that short-term rates would stay low or that long-term rates would go lower. Now it must pay more than  $4\frac{1}{4}$  percent for long-term money. A few weeks ago it paid 4.7 percent for one-year money. But it must be said that the Treasury and Federal Reserve authorities acted through the post-war years with the inflationists in Congress constantly breathing down their necks.

A final question has to do with the independence of the Federal Reserve System. Certainly it should be free from direct political interference, dictation, or pressure. But a further question is whether any governmental administrative body, no matter how set up, can be granted wide discretionary power without excessive political pressure being put upon it to inflate. What is necessary is to reduce the range of administrative discretion, to move in the direction of fixed, almost "automatic," rules. The most important step in that direction would be a return to the gold standard. ❁

## Nobody Wins a Strike

August 17, 1959

The losses suffered through a strike—by the companies, by consumers, by the country, by the strikers themselves—are obvious to nearly everyone. Why, then, are there strikes? Surely there must be a gain somewhere—at least to the strikers, assuming they "win"—that more than makes up for all the anxiety and hardships and losses suffered.

This at least is the assumption on which strikes are called. But it is amazing how seldom this assumption is subjected to statistical test; how seldom, either before, during, or after a strike, anybody bothers to draw up a profit-and-loss sheet. Yet in most cases this calculation would not be difficult. It is already clear,



for example, that even if the present steel strikers won their full demands, they would still be worse off than if they had not struck.

David J. McDonald's final demand was for an increase of about 15 cents an hour. But the steelworkers in May, according to official statistics, were already being paid \$3.10 an hour and \$127.10 a week. The addition of 15 cents an hour would add about \$6 a week. This means that it would require more than twenty weeks of work at the increased wage to make up the loss from each week of strike idleness. When the present strike had run two and a half weeks, therefore, the workers had already lost as much as they could make up by a full year's work, even after a "complete victory." And as the companies had merely suggested a one-year wage freeze, this means that the strikers are already worse off than if their leaders had accepted the companies' offer.

### LOSSES NEVER MADE UP

Such a calculation is, of course, necessarily to some extent hypothetical, comparing actualities with might-have-beens. It would change with different assumptions regarding the future. But a survey of the actual gains and losses of previous steel strikes since the end of World War II shows that the steel strikers themselves have lost heavily on net balance from every prolonged strike, even when they "won."

In the steel strike of 1956 each worker lost about \$600 in wages as a result of six weeks' idleness. Even at the end of the three-year contract that he won he made up only \$190 of this, leaving him about \$400 worse off than if he had not struck.

The 1952 strike was over the issue of a union shop, and not over wages. The strike continued for seven weeks after the companies had offered the wage increase which was finally accepted. During these seven weeks the total wage loss was \$595 per worker. Even after deducting one-month additional retroactive pay granted by the companies, and an average of two weeks' vacation pay collected by some employees for the strike period, there remained a \$395 loss which they never recovered.

### KEEPING A SCORECARD

In the 1949 strike, the loss of previous average weekly earnings of \$64.49 over a seven-week period meant a loss of \$454.93 per employee. But as there were no wage increases granted even after the strike, this loss was never made up.

In the 1946 strike, the loss of \$53.06 of previous weekly wages for more than four weeks meant a loss

of \$219.67 per employee. Prior to the strike the companies had offered a 15-cent-an-hour increase if they were allowed to raise steel prices. The intervention of President Truman forced the companies to pay an 18½-cent increase, or 3½ cents an hour more, for a one-year contract. This meant that at the end of a full year's work at a 40-hour week the steelworkers had earned back only \$72.80 additional, and were still about \$146 worse off than if they had not struck.

In the four major postwar steel strikes (excluding the twelve-hour strike of 1955) the total direct loss in wages to all the strikers, it can be calculated, came to more than \$830 million, most of which was never recovered by the strike "gains."

Nobody wins a prolonged strike. The strikers lose most of all, even when "victorious." The union leader, of course, gets in the headlines. He strikes Napoleonic poses and displays his immense power. But if the union members kept a score card, it would considerably change their attitude toward melodramatic strike calls. ❁

## Real Labor Reform

August 24, 1959

None of the legislative proposals now being debated in Congress deal with the central labor problem today. That problem is symbolized by the present steel strike. Regardless of what comes out of the House and Senate, it will clarify our thinking to ask ourselves what real labor-reform legislation would seek to do.

In his broadcast to the nation of Aug. 6, the President made the remarkable statement that "The legislation we need has nothing to do with wages, or strikes." But wages and strikes—the power of a single man to bring a nationwide industry to a halt unless his inflationary wage demands are granted—are precisely the main problems we need to deal with. The corruption of a few labor leaders is also a problem; but it is not the central one, and it would probably disappear if the main problem were courageously dealt with.

There is no doubt that the reforms the President asks for are needed. The question is whether they go far enough. For example, it is clear that a union official ought not to be allowed to put "a picket line outside the plant, to drive away customers, to cut off deliveries" in order to "force the employees into a union they do not want." But should a union be allowed to use intimidatory mass picketing to enforce any other demand, even a "legitimate" one? Does the end justify the means? Is not all coercive picketing "blackmail" picketing?

## MASS PICKET LINES

Yet all major steel strikes have been enforced by mass picket lines. Because of this the companies have not dared to try to continue production in any of the major steel strikes since the end of World War II. Workers who would have found the terms offered by the companies acceptable have not dared to apply, or to continue work.

The overwhelming majority in Congress not only calmly accepts all this, but a group under the leadership of Senator Symington is pressing a resolution calling on the President to appoint a special fact-finding board to recommend settlement terms. This is, in effect, an attempt to do for David McDonald what he cannot do for himself, even with the one-sided advantage that existing labor law already gives him. These senators must know very well that their “fact-finding” board would not dare to bring in a recommendation for a settlement that would award no more than the companies have already offered. They know that McDonald would not accept such a settlement. What they are proposing, in effect, is compulsory arbitration that would force the companies to yield enough of the steel union’s demands so that McDonald would consent to let the country make steel again.

## ‘THE RIGHT TO WIN’

Yet, in a way, these senators are only taking the next step to which existing legislation and union ideology logically lead. If employers are to be legally compelled to “bargain with” a specified union, no matter how unreasonable its demands; if this union is legally assigned exclusive bargaining power for all employees in a unit, and not merely its own members; if this union is allowed to set up mass picket lines to prevent an employer from offering the jobs abandoned by the strikers to other workers, and to prevent other workers from applying for them; and if, even with the cards thus stacked against them, the employers do not yield to the strikers’ demands, then the only way to get the industry going again is for the government to interfere still further and *order* the employers to grant enough to satisfy the strikers.

Thus the right to strike has come to be interpreted as the right to win a strike. A built-in inflationary process is set up by which unions are to win new rounds of wage increases without end, while the monetary authorities are directed to insure full employment, at no matter what wage level, by offsetting excessive money wages with more inflation.

What is needed is not new legislation, which the union leaders can assail as a “legalistic strait jacket,” but primarily the repeal of special union immunities and

privileges, above all of the privilege, not granted to any other group, of private coercion. Once that privilege were removed, the problem of labor racketeering would easily sink to manageable dimensions. ❁

## How the Spiral Spins

August 31, 1959

For years we have been talking about the inflationary wage-price spiral. But Washington (by which is meant both the majority in Congress and officials in the Administration) talks about it for the most part as if it were some dreadful visitation from without, some uncontrollable act of nature, rather than something brought about by its own policies.

Let us see just how those policies, over the last 25 years, have produced the wage-price spiral. First of all, under a series of laws beginning most notably with the Norris-LaGuardia Act of 1932, followed by the Wagner Act and by its later modification, the Taft-Hartley Act, we decided that labor troubles developed chiefly because there was not enough unionization and because unions were not strong enough.

Therefore, we in effect put the Federal government into the union-organizing business. We compelled employers to deal exclusively with the unions thus quasi-officially set up, regardless of how unreasonable the demands of these unions might turn out to be. Though illegalizing all efforts to deny employment to workers who joined unions, we explicitly legalized arrangements to deny employment to workers who did not join unions.

## THE RIGHT TO COERCE

But worst of all, we gave to the unions and union members a privilege not granted to any other associations or individuals—the power of private coercion and intimidation. By the Norris-LaGuardia Act we in effect prevented either employers or nonunion employees from going to the Federal courts for immediate relief from irreparable injury. We refuse, contrary to legal practice in every other field, to hold a union liable for the acts of its agents. We tolerate mass picketing, which is intimidating and coercive, preventing employers from offering to other workers the jobs abandoned by strikers, and preventing other workers from applying for such jobs. And then we are astonished and indignant when these special privileges, against which we provide no effective legal protection, are “abused.”

The inevitable result of these laws is that we have built up huge unions with the power to bring basic

national industries to a halt overnight. And when they have done this, we can think of no way of getting an industry started again except by giving in to the demands of the union leaders who have called the strike.

This accounts for the upward push on money wage-rates. But it does not account for the inflationary spiral. The effect of pushing wage-rates above the level of marginal labor productivity, taken by itself, would simply be to create unemployment. But as F.A. Hayek has put it: "Since it has become the generally accepted doctrine that it is the duty of the monetary authorities to provide enough credit to secure full employment, whatever the wage level, and this duty has in fact been imposed upon the monetary authorities by statute, the power of the unions to push up money wages cannot but lead to continuous, progressive inflation."

### NOT FACING THE ISSUE

Soon or late our Federal lawmakers and administrators must face up to the labor-union-boss dictatorship and the wage-price spiral that their own laws and actions have created. But they refuse to do this when each new crisis arises. When a nationwide steel strike is prolonged they become panicky. They seek to settle it by the only means that seem possible to them—by giving in once more to union demands, by granting still another wage increase and setting off a new upward wage-price spiral.

Senators demand that the President appoint a "fact-finding" board to "recommend," i.e., to impose, in effect, compulsory arbitration that would compel the employers to grant another increase to employees who (at \$3.10 an hour, compared with average factory earnings of \$2.23 an hour) are already among the highest paid workers in the country.

Thus one government intervention begets a further government intervention. Because government has failed in its primary task—that of preventing private coercion—senators ask, in effect, for price and wage-fixing; and we are driven toward totalitarian controls. ❁

## Painting Ourselves In

September 7, 1959

The labor laws and administrative and court decisions of the last 27 years have finally produced a situation where there seems no way of settling a strike except by forcing employers to give in to each succeeding union demand for higher wages or fringe benefits.

One reason Presidents have been slow to resort to the injunction provisions of the Taft-Hartley Act is that they have recognized that such a step does not assure

any solution. People do not cool off during the 80-day "cooling off" period. If negotiations got nowhere in all the weeks before the strike, there is little more reason to expect them to succeed during the 80 days. And union leaders, like David J. McDonald, have a plausible excuse for calling the forced return to work a "slave labor" device.

Recognition of the weaknesses of the "cooling off" period brings pressure for compulsory arbitration, under whatever thin disguise. One such disguise is government "fact-finding." But the fact-finding report recently made public by Secretary Mitchell, though as full and impartial as could reasonably be desired, merely served to emphasize the truth of the President's earlier remark that the "facts" in the steel strike were already pretty well known. Each party emphasizes the particular facts or interpretations that serve its case.

### FACTS THAT STAND OUT

The facts most likely to impress the public are that hourly earnings of the steelworkers have increased 85 percent since January 1950, and were \$3.10 an hour just before the strike compared with \$2.23 in manufacturing as a whole. Any further increase in steel wages, even apart from its effect on steel prices, would be certain to provoke a new round of demands for wage increases by other workers determined to catch up.

Contrary to a widely held opinion, "fact-finding" does not unerringly indicate what the "right" settlement of a wage dispute should be. There is no scientific formula by which we can determine a "correct" price or a "just" wage. In a free economy, prices and wages are determined by supply and demand. Competition and comparative incentives determine particular wages, prices, and cost-price relationships. It is failure to recognize this that brings political pressures for compulsory arbitration. This would lead directly into government wage-and price-fixing, throw every wage and price into politics, and finally produce the suffocating controls of a totalitarian economy.

The injunction provisions of the Taft-Hartley Act were an attempt find a substitute for the rights taken away from employers and non-strikers by the Norris-LaGuardia Act of 1932. That act denies injunctive relief to persons suffering irreparable injury from unlawful conduct. By it the government has abandoned its first duty—that of preventing private coercion.

### TOLERATING COERCION

That the performance of this duty would be the first step toward halting the wage spiral and solving the labor problem is beginning to be recognized. As Edward H.



Chamberlin, the Harvard economist, wrote in the June *Atlantic Monthly*:

“The threat of potential violence and intimidation through the device of the picket line are powerful factors—so powerful, in fact, that nowadays a firm rarely attempts any operations at all if a strike has been called, although it would be within its legal rights to do so. For all practical purposes the alternative of making a bargain with anyone other than the union has been removed. . . . Should a union be allowed to strangle a business economically by arranging with the teamsters to cut off its transportation? It seems to me we might as well ask if a physically strong customer in a retail shop should be allowed to twist the arm of a shopkeeper in order to drive a better bargain with him.”

The right to strike is too often interpreted as the right to win a strike. But if it is unthinkable that any strike should be broken, if no strike is to be lost, then every strike must be won. The tolerance of mass picketing gives enormous incentive to irresponsible strike-calling and to the wage-price spiral. Until our lawmakers face the implications of this, the labor problem will grow. ❁

## Shortcut to Inflation

September 14, 1959

If the Democrats in Congress object to being called the Party of Inflation, it is hard to understand why they do so many things to earn the title. Nothing so greatly increased the probability of more inflation as the action of the Democratic leadership in the House Ways and Means Committee in shelving the President's request to remove the statutory 4¼ percent interest ceiling on government bonds running five years or longer.

The law that set this ceiling was passed more than 40 years ago, in 1918. It did no harm as long as it remained completely academic—that is, as long as the market rate for government bonds was well below the ceiling. But when the market rate the government must pay is higher than the ceiling, as now, any statutory limit becomes pernicious.

The President first requested Congress to remove the statutory 4¼ percent interest-rate limit on June 8. After a month, the House Ways and Means Committee replied with a transparently political solution giving the President the right, as a sort of personal favor, to disregard the interest-rate ceiling for a period of not more than two years if he found higher rates necessary “in

the national interest.” Then, suddenly, the committee decided not to recommend even this.

### HAND TO MOUTH

The practical effect is to prevent the government from offering any long-term bonds whatever, and to force it to do all its borrowing on a hand-to-mouth basis a few months at a time. If the result of such a restriction would be grave for any business concern or corporation, the evil is multiplied enormously when applied to the Federal government, compelled to manage a national debt of almost \$290 billion, and forced to borrow \$85 billion in the next twelve months simply to cover maturities, redemptions, and seasonal cash needs. The President's second message of Aug. 25 clearly described the probable consequences of this:

“The vital interest of all Americans is at stake because excessive reliance on short-term financing can have grave consequences for the purchasing power of the dollar. The issuance of a large amount of short-term Treasury debt would have an effect not greatly different from the issuance of new money. Because these securities are soon to be paid off, their holders can treat them like ready cash. Moreover, short-term securities are more likely to become lodged in commercial banks. When a commercial bank acquires a million dollars of governmental securities, bank deposits rise by a million dollars. This is the same as a million-dollar increase in the money supply. When the money supply builds up too rapidly relative to production, inflation is the result. The piling up of an excessive amount of short-term debt poses a serious threat that may generate both the fear and the fact of future inflation at an unforeseeable time.”

### FALSE ECONOMY

There are many congressmen who sincerely believe that they are “saving the government money” by forbidding the Secretary of the Treasury to offer long-term bonds at a rate to yield more than 4¼ percent. The irony is that their prohibition will have exactly the opposite of its intended effect. When the long-term market rate is higher than 4¼ percent, the Treasury is forced to do all its borrowing at short term. This concentrates the demand for funds on the short-term market, and forces up short-term rates.

Already, in recent weeks, the Treasury has had to pay 3.9 percent interest for 91-day borrowing, the highest since the dark days of March 1953. It has had to pay 4.5 percent interest for 182-day borrowing, the highest ever paid for this term. And it has had to pay 4.7 percent for one-year borrowing. The belief that short-term borrowing is always necessarily cheaper than long-term borrowing is a myth.



And the crowning irony is that it is precisely the cheap-money zealots who have brought on the inflation that has forced the government to pay double price for everything. They have finally created a situation that is forcing both more inflation and higher borrowing rates. For lenders seek to protect themselves against erosion of their dollar principal. ❁

## Oil Import Quotas

September 21, 1959

The action of the Eisenhower Administration, first in calling for voluntary" restrictions on oil imports, and finally, last March, in imposing mandatory import quotas, has been in need of a thorough, balanced analysis. This analysis is now supplied in a 70-age pamphlet by William H. Peterson, associate professor of economics at New York University, published by the American Enterprise association of Washington.

Dr. Peterson's study fails to find any adequate cause to justify restriction of oil imports. On the contrary, he believes that the program must hurt our foreign relations, weaken national defense, deplete domestic oil reserves and undermine the vitality of the American oil industry. In addition, it is costly to U.S. consumers and establishes precedents for still further government interventions incompatible with a free economy. He recommends that the entire quota program be disestablished as promptly as possible.

### SOME CONCLUSIONS

Here are some of his conclusions:

1—Our national defense does not depend solely on oil wells within our continental borders. Previous administrations encouraged American oil investments overseas precisely to strengthen national security. In both world wars imported oil, American- or foreign-owned, was essential to us. Our air, land, and sea bases, around the globe, depend on foreign oil.

2—American oil investments have raised living standards in many foreign countries. By importing their oil we gave convincing demonstration of the benefits of "trade—not aid."

3—Our oil import quotas violate the policy of greater international trade and invite retaliation against American exports.

4—Long-range studies show that U.S. reserves of *economical* oil are wholly inadequate to meet national consumption, The U.S. consumes 54 percent of the free world's current consumption, but has only 13 percent of the free world's reserves.

5—From 1954 to 1958, U.S. demand for petroleum products rose by 15.5 percent. Domestic crude-oil reserves, despite unprecedented drilling and exploration, increased only 2.8 percent. "It would therefore hardly be in the national security interest to consume domestic crude reserves at the fastest possible rate and at the highest possible price."

6—Competition from natural gas in recent years has had far greater adverse impact on the domestic crude-oil industry than have oil imports. Yet since natural-gas production is essentially a part of the domestic petroleum industry, governmental restrictions can hardly be applied.

7—Oil import restrictions force up the prices of fuel oil and gasoline, penalizing every American consumer. An unnecessary bureaucracy must be maintained.

8—Oil import quotas, whether on a historical basis or on a basis of refinery capacity, stifle competition and inevitably create inequities. It is impossible for bureaucrats to determine the "proper" level of imports or a non-"excessive" price for petroleum products. Such decisions will be influenced by political pressures from domestic oil and coal producers.

9—If restrictionism is still believed necessary to achieve national security aims (which Dr. Peterson does not concede) the fairest and least injurious way to restrict would be through tariffs, not through quotas.

### NEW POWER SOURCES

I subscribe to all these conclusions, and would add only one. The way to provide for our long-term economic productivity and national defense needs is not to restrict imports of foreign oil, but to develop, through research, new sources of heat and power—solar energy, nuclear power plants, "fuel cells" producing electricity from chemical reaction, etc. Oil companies, in self-protection, might take the lead in such research.

Meanwhile, what seems called for is encouragement of oil imports rather than restriction. A barrel of crude imported means practically a barrel of crude left in the ground, whether proved or as yet undiscovered. After World War II, the Navy bought substantial amounts of Middle Eastern oil explicitly, in the words of Navy Under Secretary W. John Kenney, to "reduce the drain on our essential reserves at home." ❁

## 'Managed' England

September 28, 1959

LONDON—The coming election may be crucial for the British economy. If the Conservatives win, as they

are widely expected to, the issue of nationalization will be dead; if the Laborites win, attempts at denationalization will be doomed—and it is by no means certain that further nationalization will be attempted.

But though England seems fed up with traditional socialism, both major parties accept the controls and other implications of the welfare state. Looking at the situation from the perspective of New York, it had seemed that with the imposition of a 7 percent Bank Rate in September 1957, followed last year by the convertibility of sterling and the active efforts toward a free-trade area, England was making rapid strides in the direction of a free economy. But action, it is now clear, was moving faster than ideology.

To see how much England is still ruled by a controllist philosophy, it is merely necessary to look at the Conservative Party's manifesto. The party promises to "double the British standard of living in this generation"; to "rehouse at least another million people from the slums" by 1965; to "take no further action to decontrol rents" in the next Parliament; to provide a road program over the next five years "twice as big as over the last five years"; and to "remodel and strengthen our powers for coping with local unemployment." This last policy could involve the most detailed government intervention, for example, by "offering capital grants to encourage the building of new factories where they are most needed, as an addition to subsidizing the rent of government-built factories." One can imagine the political pressures and economic distortions arising from such a program.

### MONEY AND CREDIT

Not less significant of the trend of British thinking is the recent Radcliffe Committee report. In May of 1957, the then Chancellor of the Exchequer, Peter Thorneycroft, appointed a committee, headed by Lord Radcliffe, "to inquire into the working of the monetary and credit system, and to make recommendations." The report, consisting of 375 closely printed pages, was published on Aug. 19. It is based throughout on the assumption not only that managed money is here to stay, but that management of money is not enough. According to the committee, it is only part of a general economic policy which must have complex aims.

Further, not only does the committee fail to insist on the independence of the Bank of England in monetary policy, as we do on the independence of the Federal Reserve, but it declares, in effect, that monetary and credit policy decisions are and ought to be political. "In our view the true responsibility for decision [on the Bank Rate] lies today with the Chancellor of the Exchequer, not with the Bank; and it would be better that this should be made explicit." Long experience

not only in England, but in nearly every country in the modern world, shows that political control of money and credit policy leads either to continuous inflation, or at best to a bumpy economy of inflation followed by jolts of deflation or stabilization crises.

### NAÏVETÉ OF GOLD

The committee's report takes permanent monetary management for granted. It treats the old international gold standard as naïve and hopelessly outmoded. "Before 1914," it says with a patronizing smile, "the maintenance of convertibility at a fixed gold value of the pound was sufficient definition of the duty of the Bank of England." It now assumes that the economy has become too complicated for producers and consumers, but can be easily managed by bureaucrats who will know just what strings to pull and which buttons to press. It regards the national debt as "an integral part, even an indispensable part of the web of claims and counterclaims that gives strength to the structure of financial institutions"—a statement that moved George Schwartz of *The London Sunday Times* to give ironic thanks to Hitler. Finally, the report assumes that economic salvation is to be achieved through government manipulation of interest rates, without explicitly recognizing what this will do to inflate the money supply, what political pressures it will generate, and why it must eventually break down. ❁

## Art of Forecasting

October 5, 1959

Is "scientific" forecasting possible? Can we, by studying enough statistics, and inventing more ingenious statistical methods, tell just when business conditions are going to get better or worse, and by just how much? Is there, perhaps, some single indicator, if we could only find what it is, that would point the future course of the whole economy?

There are many professional forecasters who would like to give that impression—by the solemnity and confidence of their tone, if not by explicit assurance or the size of their fees. But a recent eighteen-page pamphlet by Henry M. Platt, *Economic Indicators: Their Use in Business Forecasting*, published by the Amos Tuck School of Business Administration at Dartmouth College, makes as lucid and intelligent an effort as one is likely to find to answer that question, and does not end with assurance.

Dr. Platt takes off from the work of the National Bureau of Economic Research, particularly in the

revised form adopted by Geoffrey H. Moore in 1950. Dr. Moore selected 21 business indicators, and divided them into eight indicators that ordinarily lead, eight that tend more or less to coincide with, and five that generally lag behind cyclical turning points.

### THE 21 INDICATORS

The eight “leaders” are: Number of new incorporations, new orders for durable goods, industrial stock prices, wholesale prices of basic commodities, commercial and industrial construction contracts, residential construction contracts, the average work week in manufacturing, and business failures.

The “coinciding” indicators are: The Federal Reserve Board index of production, nonagricultural employment, unemployment, bank debits outside of New York City, freight-car loadings, wholesale prices (except of farm and food products), corporate profits, and the gross national product.

The “lagging” indicators are: Personal income, retail sales, consumer installment debt, bank rates on business loans, and inventories.

Now though these indicators were chosen empirically, Dr. Platt tries to show that there are good reasons for each of them to act or turn as it generally does in relation to general business activity. He begins by briefly describing what he calls the “self-generating cycle,” according to which a revival, once begun, tends to be cumulative, to reach a peak, then to break, and to turn into a cumulative downswing or recession, which in turn reaches a bottom and generates forces that bring about revival again.

Dr. Platt tries to show why, for example, the eight “leading” indicators tend to lead. The first six all represent or reflect investment commitments. Investment commitments are present actions based largely on plans or expectations for the future—that is to say, on “economic forecasts.” Similarly, he tries to show why the coinciding indicators coincide and why the lagging indicators lag.

### THEY CAN'T PREDICT

But when he is all through, he is obliged to conclude that “Economic indicators cannot predict when a business turning point will occur.” Further they “can give no idea of how intense a revival or recession will be, or how long it will last, until it is well under way”—i.e., until it is too late.

Dr. Platt also gives some of the reasons for this disappointing conclusion. “Genuine reversals in some series usually cannot be confidently distinguished from random fluctuations until some time has elapsed.” “It

takes time to gather and transmit the data that show an indicator’s curve *has* turned.” Though the “leading” indicators reflect business expectations, those expectations may themselves turn out to be wrong.

One can think of additional reasons. It is not merely that all statistics reflect merely *past* events; or that they can never adequately cover the infinite number of economic developments. But business is often tremendously affected by developments from *outside* the purely “business” world, from government interferences to revolutions and wars.

This does not mean that it is useless to study, refine, or follow business statistics. It does mean that business forecasting is not a science but an art, depending heavily on personal judgment, hunches—and luck. ❁

## Conservative Revival

October 12, 1959

Adam Smith’s *Wealth of Nations*, published in 1776, had tremendous influence on practical policy; but that influence did not reach its peak until 50 or 60 years later. Karl Marx’s *Das Kapital*, published in 1867, has also, alas, had tremendous influence—yet even that influence did not reach major importance until a half century after publication.

These examples illustrate the truth of Lord Keynes’s observation, in his *General Theory*, that “the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the whole world is ruled by little else. . . . Not, indeed, immediately, but after a certain interval. . . .”

Today conservatives and true liberals are entitled to take some comfort from this reflection. For though in practical politics, especially in America, the assumptions of statism, socialism, paternalism, and inflationism were never more prevalent, there are increasing signs in the academic and intellectual world of a turn in thought. If we confine our attention merely to what has happened so far in 1959, I do not think one could name a year in the last 30 in which so many consciously conservative books of high quality have appeared.

### THE 1959 RECORD

Some of these have already been mentioned in this column. They include *The Roots of Capitalism* by John Chamberlain; *Power Unlimited—The Corruption of Union Leadership* by Sylvester Petro; *The Public Stake in Union Power*, a collection of sixteen lectures by leading economists, edited by Philip D. Bradley, and *Protracted*



*Conflict*, an analysis of Communist strategy, by Robert Strausz-Hupe and associates.

But there are many other important books that I have not had the opportunity to review or discuss. In the purely economic field there is *Managed Money at the Crossroads*, an analysis of the European experience by Melchior Palyi, one of the most devastating attacks on monetary planning and built-in inflation that has appeared in a generation. More largely in the political field there are *The Rise and Fall of Society* by Frank Chodorov; James Burnham's *Congress and the American Tradition*, and Allen Drury's powerful Washington novel, *Advise and Consent*. In the international field of the cold war there is Willi Schlamm's *Germany and the East-West Crisis*, a best seller in Germany itself.

Then there are books in the more general fields of the arts, culture, morals, and education. Outstanding among these are *The Freudian Ethic, an Analysis of the Subversion of American Character* by Richard LaPiere, professor of sociology at Stanford, and *The House of Intellect* by Jacques Barzun, provost of Columbia University.

#### SEMANTIC PROBLEM

Though most of the books mentioned above are by university professors, they all repudiate one or another aspect of the statist-socialist-Jacobin-newdealist-unbuttoned—"liberal" ideology that has dominated American economic, political, cultural, and academic life since the days of the New Deal. But one problem is that there is no entirely satisfactory name either for the philosophy which is being rejected or for the new philosophy which in contrast, is now being expressed.

This is illustrated by two of the books that must stand high on the list. One is *The Evolution of a Conservative* by William Henry Chamberlin; the other is *Up From Liberalism* by William F. Buckley, Jr. Both authors call themselves conservatives. Chamberlin writes: "Conservatives should stand strongly for a government of limited and divided powers, kept in equilibrium by a system of checks and balances." Yet this was a central tenet of the liberalism of the eighteenth and nineteenth centuries. Buckley brilliantly excoriates a philosophy he calls Liberalism, yet nearly all the doctrines he decries are the opposite of those of traditional liberalism. Notwithstanding the present confusing state of the vocabulary with which we are compelled to deal, a turn of thought away from paternalism, statism, and socialism, and toward conservatism and self-discipline is increasingly perceptible. ❁

## Progress vs. 'Plans'

October 19, 1959

When the present writer went to Europe in 1947, his chief impressions were those of bombed buildings, disrepair, half-empty shop windows, scarce, outmoded products, "austerity" programs, price controls, a chaos of inconvertible currencies, and dark, deserted streets at night. A month now in Europe, particularly if the stop-offs are few and somewhat haphazard—Oxford, London, Paris, Vienna, Athens, Delphi, and the Greek Islands—may not provide the most satisfactory basis for a representative economic comparison. But it does impress one anew with the enormous progress that Europe has made in the last dozen years.

Last year I wrote about the incredible amount of new building in Germany and Italy. This year I found the amount of new building around Vienna and in Greece hardly less incredible. In Greece new houses, apartments, hotels, roads are being constructed everywhere; half of Greece looks as if it had been built in the last six years. Vienna and Athens, no less than London, Paris, Frankfurt, and Rome, now have their neon lights and traffic jams.

#### EFFECT OF PEACE

What has led to this result has not been wise public policies but principally peace. It is only four years since the Russians got out of Austria and nine since Greece has been free of war and civil war. The result is a seeming miracle. Once more we have an illustration of Macaulay's thesis that: "No ordinary misfortune, no ordinary misgovernment, will do so much to make a nation wretched as the constant progress of physical knowledge and the constant effort of every man to better himself will do to make a nation prosperous."

Where governments have followed free market policies, as in West Germany, progress has been far more striking. But there has been progress even in highly socialized economies. This was brought out in some of the papers presented at a conference which I attended at Oxford of the Mount Pelerin Society, made up of economists from a score of different countries. Prof. Bruno Leoni, for example, of the University of Pavia described in detail the extent of government ownership or operation of Italian industry: Eighty percent of the production of cast iron, 45 percent of the production of steel, 80 percent of shipbuilding, 60 percent of natural gas, 99 percent of coal production, 30 percent of electrical energy—and practically 100 percent of the railroad system, the telephone service, and radio and television.



## ITALY AND INDIA

As a result, one person in every three in Italy now depends directly or indirectly on the government for his living. But Leoni sees no justification for this immense socialization (much of it inherited from the day of Mussolini) and cites some of the enormous wastes under it. The government-owned Ansaldo Fossati tractor factory at Genoa has accumulated a deficit of 18 billion lire since 1950 which is 4 billion lire more than would have been sufficient to keep all the factory's workers at home and pay them a full wage. The main product of this factory was a practically useless heavy tractor. Yet there are very good private tractor manufacturers in Italy like Fiat, who sell their products profitably.

But sometimes government control and socialization become greater than an economy can endure. Prof. B.R. Shenoy of Gujarat University fears that this is the case in India. His paper drew a dramatic contrast between what has happened since 1948 in the free market economy of Germany and in his own socialized and "planned" country. Even in the eight years since 1950, "German national income (at current prices) more than doubled, the annual average increases in it being 15.9 percent (probably a world record for a sustained rise at this high rate) [and] real wages went up by 60 percent" whereas India's economic product in recent years has barely kept pace with its population growth. "He who can rescue the country from its present economic policy and bring about a change-over to a free market economy will have done more in speeding up Indian economic development than all the foreign aid that is being planned, or that the country has received." ❁

## Is Bargaining Free?

October 26, 1959

Twenty-seven years of experience have demonstrated not that our federal labor law is "inadequate" to deal with strikes, but that it encourages and strengthens them. Eventual settlement of nationwide strikes has come not because of the Taft-Hartley Act, but usually in spite of it.

When the President, after holding off thirteen weeks, finally resorted to the emergency provisions of the Taft-Hartley Act, his action was widely criticized. David J. McDonald denounced "injection of Taft-Hartley into this situation" and forcing "free American steelworkers back into the mills." He professed to favor leaving the decision to "free collective bargaining." Senator Kennedy accused the Administration of

trying to "break the strike." He urged the "necessity of Congress's rewriting the national emergency section of the Taft-Hartley law in order to prevent a repetition."

Those who favor a free economy should sympathize with these objections. It is not desirable that men should be ordered back to work. But it is either uninformed or disingenuous to talk as if this were the first interference by the government in the steel strike. Existing Federal law heavily loads the dice in favor of union bosses and strikers. The Norris-La Guardia Act of 1932 enormously strengthens the power of strikes. It in effect deprives those who want to work of their right peaceably to continue in their jobs and the employer of his right to try to continue his business unmolested. For it denies injunctive relief to persons suffering irreparable injury from unlawful conduct.

## COMMON-LAW RIGHTS

The emergency provisions of Taft-Hartley, giving the Federal government the right to seek injunctions, are a fumbling attempt to find a substitute for the common-law rights denied to private persons. But the Taft-Hartley attempt goes too far in the wrong direction and not far enough in the right one. It orders workers back to their jobs against their will—whereas the court injunctions formerly granted to private parties merely ordered strikers to desist from violence, mass-picketing, or vandalism—in short, merely to desist from clearly unlawful interferences with the rights of others. On the other hand, the Taft-Hartley provisions not only allow a strike to be resumed in 80 days, if no agreement is reached; but they also allow the strikers to resume mass-picketing and other forms of intimidation.

In directing his attention at last to the Taft-Hartley Act, Senator Kennedy now concedes by implication that neither the bill he sponsored nor the law he got deals with the central labor problem today. This is the power the law puts in the hands of a single union or a single labor leader to shut down a nationwide industry until his demands, no matter how unreasonable, are met.

## NEED FOR REPEAL

The chief cure is not still further government interference in labor relations, as represented by the Landrum-Griffin law, but modification or repeal of existing legislation. What is most urgent is repeal of the pernicious Norris-LaGuardia Act. This alone might have permitted steel companies to continue operations. It would also be desirable either to repeal the Taft-Hartley-Wagner Act completely (a step which union spokesmen sometimes profess to favor) or to amend it drastically—by abolishing, e.g., the government grant

of *exclusive* bargaining power to unions which represent a mere majority of employees.

McDonald still professes to favor “free collective bargaining.” But this phrase is a mockery when one party, the employer, is not at all legally free to choose the person or persons with whom he can bargain—to turn to B, say, when he cannot make an acceptable bargain with A. Moreover, what McDonald and others who use this cant phrase have been asking is that the President appoint a “fact-finding” board with power “to make recommendations.” If this is not asking for compulsory arbitration, it is at least trying to get a government board to force more concessions out of the companies than “free collective bargaining” has succeeded in doing.

Why not try restoring genuine freedom of bargaining, collective and individual, to employers and workers? ❁

## It Hasn't Been Tried

November 2, 1959

Will even the disaster of the 1959 steel strike cause us to ask ourselves whether practically the whole Federal labor legislation of the last 30 years has not been misconceived? Whether it has not gone in the wrong direction, toward one-sided and ever increasing government control? Whether it is not necessary to make an agonizing reappraisal of the whole New Deal approach, and retrace our steps toward freedom? Neither the history of the last dozen years, nor the tenor of current discussion, encourages affirmative answers.

Consider what has happened. The steelworkers, as a result of a smashing series of union victories, were, before the strike broke out, the highest paid major group of workers in the country. This means that they were the highest paid major group of workers in the history of the world. They were averaging \$3.10 an hour compared with \$2.23 for manufacturing industry as a whole.

David J. McDonald assumed that these smashing victories could go on forever. He ignored the height to which steel wages had already been boosted. He ignored the reduction of employment in the steel industry that had followed his 1956 victory. He ignored the competitive inroads that foreign steel was already making on the American industry's market. He ignored the further inflationary pressure to which another substantial

increase in steel wages was bound to lead. He made extravagant demands and recklessly called a strike.

### LOST WAGES

But the longer the strike went on the more difficult it became for McDonald to agree to a compromise of any kind. Even if his full demands were now met it would take years for the steelworkers to earn back their losses from strike idleness—to bring them to where they would have been had they not struck at all. That is why McDonald had to reject every offer by the companies with increasing vehemence as “a mess of nothing,” “infamous demands,” “a black-snake whip on the backs of the workers.”

It is bad Federal laws, government intervention, increasing government controls, that have given this man and his union the power to bring a vital national industry to a halt. But as the paralysis was prolonged there was a rising demand from many politicians and press commentators not for a modification or repeal of these laws, but for still more government intervention and control. What they ask is compulsory arbitration, perhaps thinly disguised as “government machinery for fact-finding and recommendations.” Of course no government body can know what a “correct” wage is any more than it can know what a “correct” price is. Compulsory arbitration would carry us step by step into complete government wage and price control and toward an authoritarian economic system. And all decisions would be necessarily political.

### COMPULSORY BARGAINING

As Mr. Eisenhower himself declared on May 5: “I deplore the possibility of putting the government into this field, either as party in negotiations, and certainly in establishing laws to fix the levels of profits and of wages and prices. Once we do that, I believe we have gone to a route that is going to hurt the American system as we know it, especially when we are going to do it in peace time.”

In finally seeking an injunction under the Taft-Hartley Act the President declared that “free collective bargaining has not worked in this dispute.” But *free* collective bargaining is precisely what was never tried. The essence of free collective bargaining is that neither party is under compulsion. Yet the steel companies are legally compelled to bargain solely with a specified industrywide union. The law gives exclusive bargaining power to that union. The law allows that union to set up mass picket lines which physically prevent the companies from trying to continue their business and individual workers from applying for employment and working peaceably at their jobs.

Why not try a courageous revision of existing law to restore free employee choice, to restore genuinely free, voluntary bargaining, collective or individual, on both sides? The President would be justified in calling a special session of Congress to do that in the 80-day injunction period. ☸

## The Real Reform

November 9, 1959

For more than a generation Federal law has assumed that the primary solution of the labor problem was to increase the workers' bargaining power. This took on the form, on the one hand, of putting special compulsions on the employer to "bargain collectively," and, on the other, of granting special privileges and immunities to the labor unions to organize, monopolize, strike, picket, boycott, and intimidate. This legislation notoriously failed of its declared purpose "to diminish the causes of labor disputes." After passage of the Wagner Act the number of strikes tripled.

The mild amendments in the Taft-Hartley Act did little to improve matters. Federal laws still encouraged strikes by making it virtually impossible for an employer to try peaceably to carry on his business with non-striking workers once a strike was called. But the urgent legal reforms have never been made. In quiet times, when there is no major strike, there seems to be no urgency and Congress does nothing. When there is a prolonged nationwide strike, it is "too late" for Congress to act. And most of those who do want to "do something" call for still further government intervention.

### TWO PROPOSALS

Two proposals are now being widely put forward. The first is for compulsory arbitration, perhaps thinly disguised as government "fact-finding" and "recommendations." What the optimistic advocates of this fail to recognize is that it would lead us rapidly toward a controlled, authoritarian, economy. The first question is whether it could be enforced. Would an employer accept a wage decision that the thought was going to put him out of business? Would a union accept a decision that its members thought was going to make them worse off than other workers? Would unions and labor leaders generally accept a situation which would cause them to lose their very *raison d'être*?

Assuming that the government was sufficiently determined and ruthless in enforcing its decisions, its problems would mount. It would doubtless begin by

assuming that it could decide each case "on its merits." How would it determine these "merits"? In 1952 automobile wages were higher than steel wages; today the situation is reversed. Which is "correct"? Suppose a government board awarded one union a 5 percent wage increase? Would not every major union immediately demand, or threaten to strike for, a similar increase? On what principle could it be denied? Would the government, in desperation, try to freeze all wages and prices where they were? Wouldn't this freeze all existing inequities? Would it not remove all the flexibility which allocates workers and production among thousands of different products to conform with daily changes in supply and demand, and reduce, distort, and disrupt production?

### LIMITING UNION SIZE

The second major proposal is that industrywide unions be prohibited; that the size of the bargaining unit be limited by law—to, say, the workers in each individual firm. Here again the question arises whether this could be enforced, or even whether it would be desirable to try to enforce it. Should we limit the right of freedom of association? It would make sense, of course, to stop putting a *legal compulsion* on the employer to bargain with an industrywide union, or any unit larger than that consisting of his own employees. But this exemption would probably be meaningless as long as other coercive union privileges—including the exclusive-bargaining-power clause—remained in the law.

Why not simply remove any legal compulsion on the employer to bargain with a specific union? Why not make collective or individual bargaining genuinely free and voluntary on both sides?

Perhaps the best solution, if we were bold enough to consider it, would be to wipe most of the Federal labor legislation of recent years off the books, including the Norris-LaGuardia and Taft-Hartley-Wagner acts, get rid of labor boards, and substitute a simple provision, enforceable in the courts, that an employer substantially engaged in interstate commerce could not discriminate in hiring or firing either against union members or against non-union members. ☸

## Where We Are Now

November 16, 1959

On Oct. 19, the U.S. Development Loan Fund announced that in future its loans must normally be used to buy goods in the United States.



I must begin by admitting that I share some of the misgivings expressed by Senator Fulbright concerning the wisdom of this policy. On its face, it doesn't look like a step toward freer multilateral world trade. It tends to defeat part of the ostensible purpose of the loans by obliging the borrowing nation to pay more for the goods it wants than it otherwise would. Under normal conditions the proceeds of dollar loans would have to be spent, anyhow, directly or indirectly, in this country.

### FRUITS OF GIVEAWAY

But Senator Fulbright seems to live in an ivory tower that shuts off part of his view of actual conditions today. Among these are (1) a deficit of about \$4 billion this year in our balance of payments; (2) a heavy gold outflow over the last two years which has brought our gold stocks to a nineteen year low; (3) a discount on the dollar in European exchanges; and (4) continuing foreign discriminations against American goods. As the President said at a press conference on Oct. 28, our aid policy has been "merely . . . increasing the gold reserves of somebody else while we have to make good the resulting balance of deficit in our own receipts from abroad. . . ."

The remedy, however, is not to tie our loans to a "Buy American" policy, but to halt our giveaway and most of our government-agency loans.

The *Wall Street Journal* succinctly recapitulated some of the facts in an editorial of Aug. 19:

"Once upon a time there was established the International Bank for Reconstruction and Development and the International Monetary Fund.

"This was during World War II and the idea, in case you have forgotten, was to provide a capital fund for economic development loans and for currency loans to the war-torn countries and the underdeveloped countries of the world.

"But this did not prove sufficient, and so we had the U.S. loan to Britain, and U.S. loans and grants under the Marshall Plan, and the U.S. loans and grants under the many names of what is now the International Cooperation Administration.

"But this was not sufficient, and so we increased the resources of the U.S. Export-Import Bank.

"But this was not sufficient, and so we set up the U.S. Development Loan Fund to make 'easy' loans repayable in local currencies.

"But this was not sufficient, and so the World Bank was broadened to include an International Finance Corp. to invest in special enterprises in underdeveloped countries.

"But this was not sufficient, and so we are now organizing a Latin American Bank and we have proposed a similar Middle Eastern Fund.

"But this was not sufficient, and so this week the U.S. launched a campaign to establish a \$1 billion world agency to be called the International Development Association. It will be used to spur economic development in underdeveloped countries on easier terms than those poor countries can get from the World Bank, the Monetary Fund, the Export-Import Bank, the U.S. Development Loan Fund, the Latin American Bank or the Middle Eastern Fund or the International Finance Corp. or from the International Cooperation Administration. . . ."

### \$69 BILLION

If, now, we tabulate, we find (see A. Wilfred May in *The Commercial and Financial Chronicle* of Oct. 29) that our postwar overall foreign aid to date totals approximately \$57 billion in net grants and \$12 billion in net credits. This brings the grand total to \$69 billion.

The present \$4 billion deficit in our balance of payments can be wholly accounted for by our foreign-aid outflow at an annual rate of \$4.4 billion. Therefore the first remedy, as I have already said, is to start drastically tapering off our foreign-aid program, which rests chiefly on dubious socialistic assumptions.

Our global spenders have yet to learn that the most important contribution we can make to international economic stability and growth is to keep our own economy strong and solvent, and to put the integrity of the dollar beyond question. ❁

## Revise Our Labor Law

November 23, 1959

There are the strongest reasons why the President should immediately call a special session of Congress to deal with the labor crisis.

"If the [steel] strike is resumed at the end of 80 days," Secretary Mitchell has declared, "the Administration will have recommendations to Congress as to what to do to settle the strike." But this is to imply that the President will take no action until more damage has been done, until still more unemployment has been suffered, until there is once again paralysis in industry.

Even if the steel strike is miraculously settled before these words appear, the nation still faces the prospect of resumption of the East Coast longshoremen's strike, the possibility of a nationwide railroad strike, and the probability of an outbreak of a new nationwide wave of strikes if the steel wage settlement is after all inflationary. If, however, the President utilizes the period of grace allowed by the 80-day injunction, he may not



only forestall future paralysis but encourage a quicker settlement of the steel strike itself.

### COERCIVE PICKETING

To find the right solution we must first of all recognize the coercion that made the 116-day strike possible. Most press and Washington comments, as well as court decisions, have been curiously oblivious of this coercion. When the strike was called, not a single plant against which it was called tried to continue producing steel. Not a single plant dared to try. If it had tried, any former striker or other worker who had applied for work (on the calculation that \$127 a week, say, was at least acceptable until something better turned up) would have been lucky to escape intact. For the union threw picket lines around the plants, and their purpose was to intimidate and coerce. As one reporter put it at the beginning of the strike: "Any 'back-to-work' drive under company sponsorship would touch off picket-line violence of a type unknown in the steel industry since the strikes of twenty years ago."

One looks in vain, either in the Supreme Court decision, or in the lengthy dissent of Justice Douglas, for any acknowledgment that this coercion exists. The Justice declaims against injunctions that, "force men back to work" and "bludgeon all workers." He praises the enactment of the Norris-La Guardia Act as ending the "easy" and "abusive" use of the injunction in labor disputes. He implies (resurrecting a hoary myth) that such injunctions were typically used to force men to work against their will, when they were in fact used to order strikers to desist from intimidatory picketing, violence, or irreparable injury.

### LICENSE TO INTIMIDATE

The fact is that today unions are in effect licensed to intimidate and coerce anyone who tries to oppose a strike. What they claim is not merely the right to quit their jobs but to prevent others from taking the jobs they have vacated. They have become in effect agencies entitled to use intimidation or violence to enforce their ends. That is why and how they can choke off at will the nation's supply of steel or of almost anything else.

The first and most important labor reform is to restore the rule of law. Employers who wish peaceably to continue their business, workers (including former strikers) who wish peaceably to apply for the jobs that have been vacated, are entitled to adequate local police protection of life, person, or property. And in order that they may get it, the first thing that must be done is to repeal the Federal legislation that stands in the way—including the Norris-La Guardia Act and either

the whole of the Taft-Hartley Act or any provision in it that abridges or clouds the employer's or the individual worker's right to freedom of bargaining.

Such a proposal is not "anti-labor" but pro-labor. It is the self-declared champions of labor who advocate or defend laws that bring about industrial paralysis, and then hysterically seek to cure the paralysis by proposals for compulsory arbitration, by Federal seizure (Harry Truman and Senators Morse and Kennedy), or by drafting the strikers into the Army (President Truman). Not until private coercion is prevented can personal liberty be secure. ⚙

## Farm Surplus Solution

November 30, 1959

In *Newsweek* of Dec. 19, 1955, encouraged by an open invitation from Secretary Benson, this department proposed a simple two-point farm program. In a book just published, *The Great Farm Problem* (Regnery. \$5), Prof. William H. Peterson of New York University refers to this proposal sympathetically. But as it was not adopted, and as, in consequence, the farm surplus crisis has grown much worse, I venture to repeat my proposal with some additional details.

The first point may sound less startlingly novel than it did four years ago. This is that Congress *stop all price guarantees and all promises of support-buying of any kind on any crop not yet planted.*

At one stroke this would stop any further accumulation of farm surpluses. These "surpluses" are created by price supports, and by nothing else. When any product whatever is priced above the real market, there is bound to be an unsold surplus. The test of a free market price is precisely that it "clears the market."

A score of other problems would also be solved by ending price supports. Farmers would cease to be encouraged to overplant, overfertilize, overproduce. Marginal farmers would be forced to turn to occupations where they would be more productive. All need for government acreage controls or marketing quotas, with their huge attendant bureaucracy, would end. We would cease to impair our foreign economic relations.

### SELL AT A BARGAIN

The one problem that this would not solve is the huge farm surpluses in which the government has already invested \$9 billion. This brings us to the second point of my program. The government should *sell its existing surpluses back to the farmers themselves.*

Each farmer would be allowed to buy, say, an amount proportionate to that of his own relative production of a surplus commodity in preceding years. To assure sale, the government would set a price both below the existing free world price and below the average farm-cost of production. Each farmer would be free to dispose of what he bought as he saw fit. He could immediately sell through the speculative markets, or store at his own expense. The difference between what he paid and what he could sell for would assure him a profit-roughly equal, say, to what he would have made by planting a new crop. His ability to buy the commodity at less than his cost of production would discourage him from planting a new crop and adding to the surplus again.

#### NO DOWN PAYMENT

The plan could be set up so that the purchasing farmer would not even need cash. The government could give him a negotiable certificate, say, entitling either him or the bearer to buy his allotted quota at the specified price. Suppose the world price of wheat was \$1.50, and Farmer Jones was allotted a certificate entitling him to buy from the government 10,000 bushels at \$1 a bushel. Jones could simply sell this "right" on the market for, say, \$5,000.

It is true that this solution would not instantly bring economic paradise. Individual farmers would for a year or two be paid, in effect, for not raising crops in which surpluses existed. Fertilizer and farm-machinery interests might be temporarily hurt. Some farm labor would have to spend a year or two doing something else. The government would take a big loss (on paper) in selling the surpluses back to the farmers. But most of this loss is inevitable anyway. At least the government would get back, instead of paying out, billions in real cash. If such a proposal had been adopted four or five years ago, some \$20 billion might have been saved.

The farm surplus crisis has reached a point where no timid compromise program can avert collapse. Secretary Benson's new proposal for support payments based on average market prices in the preceding three years is of course not as preposterous as the present "parity" formula based on the years 1910–14. But any support price whatever above the market must simply pile up new surpluses. The government already has \$9 billion tied up in surpluses, including a two and a half year supply of wheat. It is costing \$1.5 million a day just to store the stuff. How insane can our policy get? ❁

## Men, Cars, Cities

December 7, 1959

In New York, already overcrowded, already jammed with traffic that crawls along fitfully or grinds to a halt, 20-, 30-, 40-, and 50-story apartment or office buildings continue to go up at record rates. One of them alone could house the population of an entire town. The problem of getting in and out of them, of moving from one to the other, by foot or car, threatens to become insoluble.

Even if we were to take drastic steps right now to solve the problem, we could not prevent it from growing. Suppose we immediately imposed a height limitation on all future buildings of twelve stories, or some equivalent limitation on cubic footage. The mere building of new structures up to that height or volume, on sites that now have less, could enormously increase crowding. Yet even this much restriction is nowhere seriously suggested. And if it were, it would probably meet the strongest opposition on the double ground (1) that it would be discriminatory against sites on which present buildings were lower, rather than already higher, than the new height limitation, and (2) that it is an abridgment of private property rights to prescribe any maximum building height or limitation whatever.

#### 'EKISTICS'

This column would be the last, as its readers know, to accept lightly any discriminatory treatment or infringement of property rights. But here is a clear case where each must accept some restraint for the good of all. It may hurt a specific property value in New York to impose a stricter building limitation on it; but it will soon hurt *all* property values in New York unless stricter building limitations are imposed.

No new principle is involved here. Everyone accepts the necessity of condemnation proceedings to put through a necessary street or road, or to widen an existing one. Everyone accepts sensible building laws against sanitary hazards or hazards of collapse or fire. Nearly all cities, including New York, have some limitations on height or building-area to insure a minimum of light and air and movement. The real question is whether present limitations are adequate or look forward far enough into the future. This problem faces every large city in the world.

In Greece, a month or two ago, I met an extraordinary man, Dr. Constantinos Doxiadis, and talked with him, in an office with a magnificent view of Athens and the Acropolis, in his new building and school. Doxiadis is an architect, engineer, city planner, and more. He is trying to found a new science—Ekistics, "the science

of human settlements”—which would draw upon all these disciplines. He has been called in as consultant or planner by Washington and Philadelphia, by Pakistan and Iraq.

### 'SECTORS'

Perhaps some of Doxiadis's premises go too far in the direction of central planning. But he seems to have recognized, better than anyone else with whose work I am acquainted, the nature and dimensions, economic, technical, and esthetic, of the modern-city problem. These new dimensions have been brought about by the unprecedented increase in world population, the propensity of people to crowd into cities, and the multiplication of automobiles.

Where once our cities were inhabited by men, they are now inhabited by men and machines. Man, Doxiadis points out, has now been displaced as the dominant element by the motor car. Our city plans, once three-dimensional, must now take account of a fourth dimension—time. This is the time wasted or saved in commuting to work or getting from one part of town to another.

The basic element of the city of the future, according to Doxiadis, will be the community neighborhood or “sector.” The size of the sector will be determined by reasonable walking distances. Outside and around the sector cars will be able to move at high speeds. They may enter it at controlled speeds to come to parking lots, dead-end streets, or areas where children play, wives shop, and pedestrians can walk with pleasure and safety. Such sectors can be planned with a fair distribution among property owners of costs and advantages. Cities, after all, are made for man, not man for cities. ❁

## The Problems We Face

December 14, 1959

All of us must constantly act on some assumptions regarding the future. But if we are wise enough to recognize that we are merely guessing, we will always be ready to revise our assumptions. Economic forecasting can never be a science. Every forecast depends upon a thousand ifs. The Secretary of Labor, for example, ought to be in a specially favored position to guess how much unemployment there is going to be six months ahead; but because he was too cocksure in April he found himself eating his hat (or a specially baked simulacrum thereof) on the steps of the Labor Department, in November.

Today we make a fetish of “economic growth.” We have already had all sorts of predictions concerning our economic growth in the next ten years. Such predictions can obviously be no better than the assumptions on which they rest. If we project the average percentage “rate of growth” over the Fifties into the Sixties, or if we extrapolate the growth curve, we will get one result. (Or several. One trouble is that our pundits cannot even agree concerning the growth rate of the past—partly because of disputes concerning statistical reliability or method, partly because of disputes concerning what year to start from as a base for calculation.)

### GROWTH NOT AUTOMATIC

If we are optimistic we will project a much higher growth rate for the Sixties than in the Fifties. If we are “research foundations” we will point out, with an air of discovery, that an annual growth rate of 4 percent leads to a higher national income at the end of ten years than one of only 3 percent, and one of 5 percent to even more than one of 4 percent. And if we are politicians, we will *demand* a higher “growth rate”—5 percent, 6 percent, or even more.

But one thing is clear. No rate of growth will take place in the Sixties automatically, regardless of what anyone does. Our economic growth (or shrinkage) will depend on the policies we follow. And the policies best calculated to increase production and living standards are those that encourage the greatest saving and investment, the maximum capital accumulation, the largest addition to and improvement of the tools and equipment that bring the highest increase in the productivity of labor. These are not, unfortunately, the policies favored by those who harp most on “rates of economic growth.” What they propose, rather, are increased government spending, continued deficits, continued inflation, and still more government “planning” and controls.

### TO HALT INFLATION

We should look forward to the Sixties, then, not as an era of automatic growth, but as a challenge, as a set of problems to be solved. And the chief domestic problem we have to solve is how to halt the inflation we have experienced over the last 26 years.

The measures necessary to halt that inflation would also solve other major problems. We would have to balance the budget—by reducing both expenditures and burdensome taxes, but reducing expenditures more. We would have to stop subsidizing unsalable farm surpluses at home and socialism abroad. We would have to stop government cheap-money policies, and the continuous expansion of our money supply, and return to the full gold standard. This would also solve the problem of our “deficit in balance of payments.”



Not least important, we would have to solve the problem created by the present power of labor unions to shut down whole industries and force money-wage increases that in turn bring political pressure for more inflation. In solving this labor problem, we may have to make a candid reappraisal of the assumptions on which our labor policy has rested for a quarter century.

Finally, we will solve neither our domestic nor our foreign economic problems unless, against floods of socialist and Communist propaganda, we refuse to lose sight of the incomparable superiority of capitalism—of our system of free markets and private enterprise—as a stimulus to maximum production and as a safeguard of personal liberty. ❁

## Is Gold Just a Relic?

December 21, 1959

Roy L. Reiersen, vice president and chief economist of the Bankers Trust Co. of New York, has proposed that we reduce or even eliminate the present 25 percent gold reserve requirement against Federal Reserve note and deposit liabilities. His proposal illustrated what happens once a full gold standard has been abandoned for a partial or make-believe gold standard.

Reiersen argues that, though our gold reserve is still about \$19.5 billion, more than half of this must be held as reserve against domestic liabilities. “Almost \$12 billion of gold is required to be held as a 25 percent reserve against approximately \$47.5 billion of Federal Reserve note and deposit liabilities, even though these are no longer redeemable in gold. This gold is thereby barred from functioning as a means for settling international accounts—the remaining essential function of gold in our monetary system.” This leaves available only \$7.5 billion of “free” gold against some \$16 billion of short-term dollar balances held by foreigners, plus \$3 billion held by the IMF and other international institutions.

### PURPOSE OF A RESERVE

The situation, Reiersen thinks, has led to fears abroad that “if further heavy inroads are made upon the free gold, the United States will be compelled to stop making gold available for international settlement and thus devalue, even though most of our gold reserve might still be intact.” On the other hand, “if the United States were to eliminate altogether a formal reserve requirement for the central bank the monetary gold stock would cover these foreign liabilities by about 100 percent.”

The astonishing thing about this proposal is that it is not made by an irresponsible inflationist but by a highly reputable banker and economist who deplors inflation. Its ostensible purpose is to strengthen our present for-foreigners-only gold standard. That it would achieve this declared purpose is improbable. Such an announcement would more likely be interpreted as dropping the last vestige of a domestic gold standard.

What, after all, was the purpose of a legal gold reserve? It was to ensure convertibility at all times of bank notes and deposits into gold. The chief purpose of this, in turn, was to prevent an undue or unsound expansion of credit and currency. The reserve ratio was a sort of thermometer; it was constantly watched, both at home and abroad. When credit expansion or a gold drain brought the reserve ratio dangerously low, the monetary authorities had to raise interest rates and halt further credit expansion to prevent a further gold drain. Reiersen’s proposal would destroy the thermometer, smash the pressure gauge, remove the warning signs and traffic signals.

### TO RESTORE CONFIDENCE

Consider the history. In 1933 and 1934 we abandoned a real gold standard, devalued the dollar to 1/35 of an ounce, put even this on a “24-hour basis,” and allowed only foreign central banks, not American citizens, to demand gold. In 1945, Congress, at the request of the Federal Reserve, reduced the legal requirement of a 40 percent gold certificate reserve against Federal Reserve notes and 35 percent against deposits to a uniform requirement of only 25 percent. At the end of 1944 total deposits and currency amounted to \$151 billion; today they exceed \$248 billion. The increase of 64 percent in the total money supply is enough to account for the increase of 64 percent in consumer prices in the same period.

Reiersen thinks that: “In the future, as in the past, we shall have to depend upon the integrity and good judgment of the Federal Reserve officials to establish a credit policy appropriate to conditions in the United States economy.” I submit that we need something much more solid to depend on than the arbitrary discretion or caprice of present or future monetary managers.

The immediate need is to halt the inflation, and to restore confidence in the dollar at home as well as abroad. To prevent resumption of inflation, we must ultimately restore the discipline of a full gold standard. Meanwhile our measures should move toward that goal and not remove the last hopes for its attainment. ❁



## Wages by Edict?

December 28, 1959

On Dec. 11, the governor of Minnesota threw a brilliant light on the one-sidedness of labor law and law enforcement in this country.

The old labor contract between Wilson & Co. and the United Packinghouse Workers of America expired on Aug. 31. Work continued on a day-to-day basis. On Oct. 29, the company broke off negotiations until "binding assurances be given us that the lawless acts started last May and continuing through the sitdown strikes of the week of Oct. 26 will not be repeated." On Nov. 3, the union's workers struck. After a few weeks the company warned them to return to their jobs or be replaced. On Nov. 30, the company tried to continue operating with nonunion labor. Hundreds of pickets surrounded the plant and resorted to violence, overturning and stoning cars of nonunion workers.

Then Governor Freeman called out the National Guard, who used fixed bayonets to restore order. But not order that permitted the company peaceably to operate its plant or the nonunion workers peaceably to process meat. The National Guard shut down the plant. Production workers hired to replace strikers were turned back at the gate. All court orders pertaining to the dispute, including one to limit pickets, were suspended.

### SOLDIERS AS PICKETS

Under the guise of maintaining peace and order, in other words, Governor Freeman called out the military not to permit peaceable production but to stop it; not to maintain the right to work but to deny it. He subverted the rule of law and turned the National Guard into an instrument for enforcing the aims and policies of the union.

The governor's highhanded action merely carried one step farther the legal premises on which our national labor legislation and our local enforcement (or non-enforcement) have rested for the last quarter-century. Unions today are tacitly granted the right not only to strike, but to prevent others from taking the jobs they have vacated. Thanks to mass picketing, with its latent

threat of violence, no struck steel plant has attempted to continue production with nonstrikers.

And our statesmen have remained willfully blind to this situation.

But now even "liberal" politicians have suddenly come to see that the labor legislation they did so much to fasten on the country leads to industrial paralysis. In panic, they seek to cure this paralysis by still more government intervention. Governor Rockefeller has come out in favor of compulsory arbitration of labor disputes, and Adlai Stevenson in favor of compulsory arbitration and even seizure of plants.

### 'THE END OF AN ERA'

True, Rockefeller opposes "any legislation setting up compulsory arbitration as an automatic and generally accepted remedy for industrial disputes, for it negates the concept of collective bargaining . . . and our economy would tend to be regulated by fiat. But the present situation points up the need for an exception." What this overlooks is that once a union were led to think it could get more by forcing compulsory arbitration through a sufficiently prolonged nationwide strike, the "exceptions" would become the rule.

McDonald is angling for government arbitration today precisely to get himself off the hook. He knows that no politically appointed board would dare to award him less than the company offer he has rejected. He also knows the history of the Railway Labor Act—how the rail unions have not hesitated to reject the awards of Presidential "fact-finding" boards that they did not wholly like (e.g., 1941), and forced boards to bring in new awards more acceptable to them. Rockefeller and Stevenson talk like men ignorant of this history.

Stevenson now declares that "we cannot tolerate shutdowns which threaten our national safety." He thinks "the steel strike has dramatized the fact that we are at the end of an era." But the era which has ended, let us hope, is that in which government has not only tolerated but built up the irresponsible private power of nationwide unions to use mass picketing and the threat of violence to prevent employers who refuse to meet their terms from continuing production peaceably with other workers. ⚙

1960



## Wage-Price Go-Round

January 4, 1960

Reluctant as this column is to engage in prophecy, it is not taking much risk in predicting that when a settlement of the steel strike does come, it will be inflationary.

Even before the strike began the steelworkers were the highest-paid major group of workers in industry, receiving an average of \$3.10 an hour compared with average factory earnings of \$2.23. The companies have already offered a three-year contract which they estimate will bring the steelworkers an additional increase of 33 cents an hour over the full period; even the union, which turned down the offer, concedes that it meant at least a 24-cent increase. The final settlement will surely not be lower.

But this means an inflationary increase. Because the steelworkers are already far ahead of the procession, the new gain is certain to let loose a tremendous wave of demands for another round of wage increases.

All this does not necessarily mean that the company managements were foolish to put up a fight. They had every reason to think, at the beginning, that their resistance would have the support of public opinion and of the Administration. They were not merely encouraged, but practically enjoined, not to make an “inflationary” wage settlement. They knew what the opposition would be to another price increase. They knew they would lose further markets to foreign producers.

### ‘NEUTRAL’ GOVERNMENT

As the strike dragged on, the government remained ostensibly “neutral.” It refused to “interfere.” Certainly it did not, as under Mr. Truman, interfere directly on the side of the strikers. But Mr. Eisenhower began to declare that he was losing patience; he rebuked *both* sides for not coming to an agreement. As he did this even after the companies had made an inflationary offer, the only logical conclusion was that he expected them to make a still more inflationary offer, if necessary, to persuade McDonald to accept; otherwise he would have expressed his displeasure with the union alone.

And all the time he, his officials, and Congress utterly ignored the fact that the Federal government had been tipping the scales in favor of the strikers from the beginning, through the operation of existing laws. The Taft-Hartley-Wagner Act set up the machinery under which the steelworkers’ union was created, and under which it became the official exclusive bargaining agency for the employees. It set up the requirement that the employers must continue to “bargain” with McDonald no matter how unreasonable his demands or his attitude. It made it in effect impossible for the

companies to treat the strikers as having quit their jobs and peaceably to hire other workers to take their place, either on the old terms and conditions or on new ones. And the Norris-LaGuardia Act, plus the absence of local law enforcement, removed from the companies protection against the intimidation of mass picketing and the threat of violence.

### IN SPITE OF THEM

Without this intervention by the Federal government (an intervention built in for a quarter-century) it is highly improbable that there would have been a 116-day steel strike for such extravagant demands, or even an industrywide steel union powerful enough to choke off the nation’s steel supply at will.

All this is ignored by the Stevensons and Rockefellers who now call for compulsory arbitration. What they are in effect proposing is that if the unions cannot get what they want even with the legislative scales heavily tipped in their favor, a government body should step in and order the employers to pay more. Theoretically, of course, the workers could be ordered to resume work for *less* than they could obtain from a continued refusal to work (which would be a violation of their basic liberties), but as the proposal comes from the professional “friends” of labor, it is obvious that they do not seriously expect this result. They merely expect additional pressure on the employer.

So we seem to be in for another round of inflation. But Administration officials and congressmen will all talk as if this had nothing to do with the policies they pursued or advocated, but had come about in spite of everything they had done to stop it. ☸

## Halt Inflation Now

January 11, 1960

Three weeks ago I discussed here the proposal of Roy L. Reiersen of the Bankers Trust Co. of New York that we eliminate the present 25 percent gold-reserve requirement against Federal Reserve notes and deposits. Because of limitations of space, I could not do full justice to that proposal. I believe Reiersen’s solution is wrong. But he has had the clear-sightedness and courage to call attention to the problem.

The problem, to restate it, is this. Though our gold reserve still stands at about \$19.5 billion, more than half of this must be held as a reserve against liabilities. About \$12 billion in gold is required to be held as a 25 percent reserve against \$48 billion of Federal Reserve notes and deposits. This leaves available only \$7.5 billion



of “free” gold against some \$19 billion short-term dollar balances held by foreigners (including \$3 billion held by international institutions).

Foreigners, says Reiersen, measure our gold losses not against our total stock of gold but against our very much smaller amount of free gold. This may lead to fears that, if this “free gold” is exhausted, we will be compelled to stop making gold available for international settlement, and thus devalue. His suggested remedy is that we either reduce or eliminate our present 25 percent gold-reserve requirement entirely, to assure foreigners that the whole amount would be available to them.

### NO SOLUTION

I do not think this step would provide any real solution. It would drop the last vestige of a domestic gold standard. It would keep the dollar temporarily good for foreigners at the cost of undermining permanently its value for Americans. If foreigners withdrew all their present short-term balances in gold, it would leave Americans with no gold backing for their dollars at all. The proposal turns the perfectly sound principle that gold convertibility ought not to discriminate against foreigners into the untenable proposition that it ought to discriminate against Americans.

And even so it would give only temporary assurance to foreigners unless accompanied by unmistakable evidence of the determination on the part of our government to halt our inflation immediately. With the gold-reserve requirement entirely removed, this assurance would have to take the form of an act of Congress, forbidding any further increase in the supply of money and bank credit. This in turn could only be achieved by not allowing any bank to increase the total of its loans and investments—which means that it could not make any new loan until an equivalent old loan had been repaid.

In the present inflationary mood of Washington, such a proposal would be dismissed as unthinkable.

### STRINGENCY NEEDED

But no solution of the problem is possible unless the inflation is halted, by whatever means. Instead of eliminating the gold-reserve requirement entirely, it ought to be restored immediately to the pre-1945 level of 35 to 40 percent—preferably to a flat 40 percent against both notes and deposits. But as the reserve has already been allowed to fall to this level, this too would mean that no further increase could be allowed in money and bank credit until our gold holdings themselves increased.

Even if we hope to remain merely on our present for-foreigners-only gold standard, we must continue to let gold, if demanded, flow out. On this point Reiersen

is right. But if we hope to keep our foreign creditors from *demanding* gold, if we mean to protect the integrity of the dollar, if we intend to prevent devaluation, we must stop the further expansion of money and bank credit by one method or another.

If this takes the form of “orthodox” measures, those orthodox measures must be stringent. The budget must be immediately balanced. (Renewed promises of a balance in the sweet by-and-by are no longer enough.) Congress must repeal the legislative ceiling of 4½ percent on long-term government bonds. Interest rates must be raised to the point where they cease to encourage further expansion of credit.

The future of the dollar depends on whether we have the stomach for such decisions. ❁

## Inflation Wins Again

January 18, 1960

As this department two weeks ago predicted, and as it took no great clairvoyance to predict, the steel strike has finally been settled by a grossly inflationary wage increase. Continuing its mood of crystal-gazing, this department predicts that the victory for the steel union will let loose a tremendous wave of demands for another round of wage increases throughout industry; that employers for the most part will be compelled to yield to these demands; that the Federal Reserve authorities will be pressured into further expansion of money and credit to make the wage increases supportable, and that neither the Administration nor Congress will do anything in the slightest degree effective to halt the consequent inflation.

Never has this department more ardently wished that its predictions would turn out to be laughably wrong. But let us look at the facts.

If there was any will to resist inflation, the steel strike was the ideal test case. Steel wages even before the strike averaged \$3.10 an hour. This was already 87 cents an hour higher than the average wage paid in manufacturing. It was already the highest wage paid to any major group in manufacturing. There was no question of “catching up with the procession.” The steelworkers were already way ahead of the procession.

### CARDS WERE STACKED

These were among the reasons, in addition to loss of markets to foreign competitors, that led the steel companies to resist a further substantial wage increase. In addition, they were under ostensible pressure from the

Administration not to grant an “inflationary” wage increase.

But as the strike wore on, it became more and more evident that the companies were engaged in a losing battle. Ostensibly, the government was “neutral”; it refused to “interfere”; it kept “hands off”; it left everything to “free collective bargaining.” But all the time, it was in fact interfering, through the operation of the Norris-LaGuardia and Wagner-Taft-Hartley acts, on the side of the strikers. All the time the union maintained intimidatory picket lines, the constant threat of violence, in case any company should try to resume production and to hire other workers. And all the time the Administration and Congress remained completely oblivious of this situation, and talked as if bargaining were really free on both sides.

It is true that Mr. Eisenhower finally resorted to the strike-injunction provisions of the Taft-Hartley Act, but both before and after he had done so he declared that he was losing patience, and rebuked *both* sides for not coming to an agreement. As he did this even after the companies had made an inflationary offer, they could only conclude that he expected them to make a still more inflationary offer to buy a settlement. Otherwise they faced a resumption of the strike, with threats in the background of compulsory arbitration or even seizure.

#### TOUGH NEXT TIME

The companies will now no doubt be roundly abused by some for having uselessly and expensively held out, and by others for finally yielding so much. And certainly the package increase of 39 cents an hour that they were forced to yield over a thirty-month period is far more costly than the settlement they might have obtained by offering more last June to avert a strike. But before we condemn the company managements we would do well to weigh the mounting pressures against them.

Only three nights before the steel settlement, New York City, already losing millions of dollars on its city-owned and -operated bus and subway lines, averted a strike only by offering an increase of 40 cents an hour over a two-year period. The private bus lines were forced to settle for an increase of 36 cents an hour. Immediately after the settlement Mayor Wagner announced that the people of the city were “sick and tired of . . . this terrible ordeal every year or every second year . . . I don’t propose to let it happen again.”

The politicians are always going to be terribly tough *next* time, but always capitulate, or force private industry to capitulate, *this* time. They have built up, by their own laws and appeasements, a Frankenstein monster they no longer dare to oppose. ☸

## Logic of Do-Nothing

January 25, 1960

Though the steel companies, as one of their spokesmen admitted, certainly “took a hell of a licking,” it does not follow that labor won. It will take years for the strikers, even with their new gains, to make up their losses during 116 days of idleness. And as the union which forced a thumping increase on top of wage rates already higher than in any other manufacturing industry also refused to permit employers to effect any savings by discarding wasteful work rules, the settlement must adversely affect employment in the long run. As Roger Blough, chairman of United States Steel, pointed out, the settlement “can certainly weaken further their [the workers’] ability to compete in the market place against the workers in steel mills abroad, as the gap between wage costs on opposite sides of the ocean continues to widen.”

As for other workers, the purchasing power of their wages will be cut by a new spiral of inflation. The price at which the Administration bought off the steel strike was a hundred new strikes, unless a new national round of inflationary wage increases is granted. The great problem now is how we can limit the damage done.

#### DON'T ACT NOW

Yet this—the most important domestic problem now before the Administration—was dismissed in the President’s long annual message with a perfunctory mention. The inflationary implications were belittled. We were told that we must depend “primarily upon the common sense of the responsible individuals,” and should “encourage regular discussions between management and labor outside the bargaining table.” In other words, the government should do nothing.

Toward any meaningful reform of our labor laws, this Administration, like its predecessors and its Democratic opponents, has developed a masterly logic of inaction. Don’t legislate during a strike, because then it is too late to affect that strike, and any such legislation would be hasty and ill-considered. Don’t legislate after a strike has been settled, because there is no longer any urgency. Don’t legislate in an election year (i.e., every second year) because such legislation will be “political” and bad. Don’t legislate until we see how the Landrum-Griffin Act (obviously ineffective on nationwide strikes) is going to work out.

We come to the paradox that nobody attempts to solve the problem precisely because it has become so serious. The politician dares not make proposals that might incur the vengeance of the union leaders at the polls. The employer fears to press suggestions

that would antagonize his union workers or arouse the resentment of their leaders.

### UNION INTIMIDATION

But the greatest obstacle to reform is the confusion and division even in the ranks of those determined to face the problem. Some ask for compulsory arbitration, failing to see that this must lead into general wage-and-price fixing. Some want to seize the companies and force them to pay what the unions ask, oblivious of the violation of private-property rights and the consequent demoralizing effects on industry and employment. Some demand making the unions subject to “antimonopoly” laws, but fail to specify what these would permit or forbid. Some want to limit the size of unions, but are vague about the limits or how their proposal would be enforced.

And all the time the central evil is ignored. This is union violence, or union intimidation through mass picketing. It was this that made the nationwide steel strike effective. It was this that made it inevitable that McDonald would win. For throughout the strike no steel company dared to try to operate. And this irresponsible union power will continue until a company is in a position to say to strikers: “Unless you are back by Monday morning, you will be considered as having quit your job, and you will be replaced.” Until a company management is in a position to say that without being haled before a labor board, until it can seek immediate relief in the courts from irreparable damage, and until it can depend on local police action to prevent mass picketing and keep the peace, the labor-union bosses will continue to have the economy at their mercy. ❁

## Notes on the Budget

February 1, 1960

**Word Inflation:** The verbal inflation in the budget has increased at an even faster rate than the dollar inflation. The signed part of the President’s message, preceding the hundreds of itemized tables, runs to 78 pages. The Budget Message six years ago ran to only fourteen pages. The increase in wordage is 457 percent, compared with an increase of annual estimated dollar expenditure of 24 percent. The comparison is not frivolous. Good government and good policy depend on the extent of public interest and understanding. Public interest and understanding are encouraged by clarity and brevity, discouraged by prolixity. The significant facts can be buried under mountains of detail. I am not yet ready to put it forward as Hazlitt’s Law, but I suspect that the

number of people who read a message varies inversely as the square of its length.

**How Good a Guess?** The President estimates that expenditures in the fiscal year 1961 will be \$79.8 billion and receipts \$84 billion, leaving a surplus of \$4.2 billion. How likely is that surplus? It is not to be achieved by any cut in expenditures, which are estimated at \$1.4 billion more than in the current fiscal year, but by an increase, from practically the same taxes, of \$5.4 billion in revenues compared with the current fiscal year and of \$15.7 billion compared with the fiscal year ended last June 30. Such an increase of 23 percent in two years would be improbable without substantial inflation; but this would mean correspondingly increased costs, which are not allowed for in the expenditure estimates.

Comparisons with the last full fiscal year, 1959, are not encouraging. For that year the President predicted a surplus of nearly half a billion. But expenditures were \$6.8 billion more than he estimated and receipts \$6.1 billion less, so 1959 ended with a deficit of \$12.4 billion. If the same absolute error were now made for 1961, we would end, not with a surplus of \$4.2 billion, but with a deficit of \$8.7 billion. The 1959 error was abnormally large. But even for the fiscal year 1958 Mr. Eisenhower predicted a budget surplus of \$1.8 billion and we ended with a deficit of \$2.8 billion—i.e., \$4.6 billion worse than the forecast. His present surplus estimate hardly justifies a Democratic spending spree.

**Cost Comparisons:** Even when we take the budget at face value, it is the biggest expenditure Mr. Eisenhower has ever proposed. This is not the result of proposed increased spending on defense. On the contrary, “major national security” expenditures, at \$45.6 billion, would be less than in 1959 or in the current fiscal year. The new budget contains the highest nondefense expenditures ever recommended. These total \$34.2 billion, compared with \$31.2 billion recommended for 1960 and \$28.1 billion for 1959 (though both increased in actuality), and with actual non-defense expenditures of \$27.8 billion in 1958, \$25 billion in 1957, and \$20.9 billion in 1954. In brief, non-defense expenditures alone are \$13 billion greater than in 1954.

Nor does even this tell the full truth about the 1961 budget. When social security and trust-fund operations are counted in, expenditures for 1961 will not be \$79.8 billion but \$96.3 billion. Total nondefense and welfare spending, at \$50.3 billion, will actually exceed defense spending by \$5 billion.

**Debt Management:** Congress will be irresponsible if it does not heed the President’s request for immediate removal of the 42-year-old 4¼ percent limitation on



interest rates on government securities maturing after five years. Such long-term securities can no longer be sold at that rate. The ceiling is highly inflationary, as it forces the government to offer short-term securities acquired by commercial banks. As the government must pay around 5 percent even on these, the ceiling on long-terms actually raises its interest costs.

**Item Veto:** The President is to be congratulated for again asking authority to veto individual items in appropriation bills. He points out that 41 state governors now have such item veto authority. It is a minimum requirement for fiscal responsibility. The only real question is whether it goes far enough. ❁

## Who Makes Inflation?

February 8, 1960

The President's annual Economic Report has come a long way since the days of Leon Keyserling. It is lucid, readable, informative, and conservative in tone. It pays more than lip service to the need for a balanced budget and to the merits of "a free society, free political institutions, and a free economy." It rightly insists that "we grow only by investing more and producing more, not simply by spending more." Many of its specific recommendations—such as the removal of the 4¼ percent interest-rate ceiling on new long-term Federal bonds—are urgently necessary.

The report is also able to point out that though inflation continued in 1959, the rate of inflation decreased. The money supply (as measured by demand deposits plus currency) grew by only one-half of 1 percent in 1959, compared with 4 percent during 1958. The consumer price index rose from 123.7 at the end of 1958 to only 125.6 at the end of 1959. The wholesale price index actually fell during the year from 119.2 to 118.8.

Yet the latest Economic Report leaves one with the same doubts as have its predecessors concerning the wisdom of the Employment Act of 1946. That act declares (though with elaborate bows to "free competitive enterprise") that "it is the continuing policy and responsibility of the Federal government . . . to promote maximum employment, production, and purchasing power."

### DOUBTS ON 1946 LAW

It has not been proved that the act has done any particular good. Thus, though the present report boasts of the great advances made in employment, income, and output in the fourteen years since the passage of the Employment Act, it also concedes that "the annual

increase of 3.2 percent in total national output" in this period "is roughly equivalent to the long-term average reached in our previous history."

But the act, by its emphasis on maximum employment and "purchasing power," and its silence concerning prices, has given added stimulus to inflation. It is not mere coincidence that since 1946, when the act was passed, the money supply has increased 32 percent and consumer prices have risen 50 percent. This inflation has made the miracle of "economic growth" seem much greater than it is. We boast of our gross national product of 1959 of \$479 billion; but if this had been calculated at the 1939 price level, it would have been only \$205 billion—not half as impressive.

Moreover, by holding that employment, production, and purchasing power are the "responsibility" of the Federal government, the Employment Act of 1946 has provided an excuse for hundreds of "programs," handouts, and interventions, and a steady expansion of Federal control. Is it really the province of government to increase employment, output, and purchasing power? Or is not its chief business, rather, to keep out of the way?

### RESPONSIBILITY

Its true function is to maintain peace, order, and justice; to protect life and property; to refrain from burdensome and inequitable taxation; to remove the punitive laws and deterrents that previous governments have imposed. Its function is to permit and preserve a sound currency. When it fails to do this, it must bear sole responsibility for the failure.

If it properly fulfills its own responsibilities, it will not need to lecture the people to take "appropriate private actions, especially with respect to profits and wages." If it did not grant labor unions special monopoly privileges, the power of intimidation and of paralyzing the economy, it would not need to declare piously and futilely that unions should not "threaten to paralyze our entire economy." And it need not declare that "price reductions warranted by especially rapid productivity gains must be a normal and frequent feature of our economy." If the government itself will refrain from monetary inflation, these price reductions are precisely what will occur. A fair field for competition will bring down production costs and prices with them.

The greatest profits will go to those who either bring down production costs the most, or improve products the fastest. The free market can settle these relationships better than the most learned government economists. ❁



## Liberty and Welfare

February 15, 1960

Sixteen years ago, in a short but very important book, *The Road to Serfdom*, F.A. Hayek sought a modern restatement of the great issue between liberty and authority. Now, pushing his researches further, he has produced a monumental work of 570 pages, *The Constitution of Liberty* (University of Chicago Press. \$7.50), exploring the philosophical foundations of freedom with a thoroughness, scholarship, rigor of reasoning, and precision of statement rarely equaled and never surpassed. It is one of the great political works of our time.

It is difficult, within the limits of this space, to convey an adequate idea of the book's scope and contents. Part I is concerned with the meaning and value of freedom. As Abraham Lincoln pointed out, "The world has never had a good definition of the word 'liberty.' We all declare for liberty; but in using the same word, we do not all mean the same thing." Hayek analyzes the many ambiguities of the word, but uses it to describe "the state in which a man is not subject to coercion by the arbitrary will of another or others." He examines the goals and methods—legal, political, economic, educational—that restrict or threaten this liberty, as well as the ideals and measures most likely to promote and maximize it. In the course of this examination, the goal of Liberty is compared with that of Equality, Majority Rule, and Democracy to determine to what extent they are compatible and, when not, which must have priority. Democracy, he concludes, though "probably the best method of achieving certain ends," is "not an end in itself."

### THE RULE OF LAW

In Part II, Hayek considers the relation of freedom to the law, and presents an illuminating historical survey of the slow growth of safeguards to individual liberty. Among these he stresses the importance of a written constitution, of federalism, limited government powers, division of powers, and judicial review.

Most of all he stresses the importance of the Rule of Law. By this he means the absence of arbitrariness, privilege, and discrimination. The law must apply to all, and not merely to particular persons or groups. It must be certain. It must consist in the enforcement of known rules. These rules must be general and abstract rather than specific and concrete. They must be prospective in their application and not retrospective. They must be so clear that court decisions are predictable. The case for the ideal of the rule of law, for its certainty, generality, and equality, is presented with unanswerable force. But Hayek is compelled to point out in a final chapter

of this section how, under the influence of legal positivism, socialism, and the drive toward a welfare state, the ideal of the rule of law has been declining.

### CREEPING BUREAUCRACY

The final section consists of eight chapters in which Hayek shows what the effects have been—on labor and employment, social security, taxation, money, housing and town planning, agriculture, and education—of the decline of the rule of law and personal liberty in the pursuit of the goals of socialism, welfare-statism, redistribution, "full employment," and inflation.

This is a series of masterly discussions which unfortunately cannot be reviewed in detail here. I must confess some disappointment in one or two of them. His chapter on "The Monetary Framework," for example, though it contains a brilliant analysis of inflation, seems to violate his own declared principles when it suggests that a restoration of the gold standard is neither practicable nor desirable, and even expresses doubt about the wisdom of tying down the monetary managers by "rigid rules" instead of depending on their discretion.

Yet these chapters in general are distinguished as much for their courage as for their intellectual penetration. No one has pointed out more clearly the dangers now facing us from inflation, paralyzing "progressive" taxation, coercive labor unions, the ever-increasing dominance of government in education, and a social-service bureaucracy with far-reaching arbitrary powers. Hayek's book is the twentieth-century successor to John Stuart Mill's essay, *On Liberty*, and the contemporary legal-political counterpart of Ludwig von Mises's economic treatise, *Human Action*. ❀

## Great No-Debates

February 22, 1960

According to Edwin L. Dale, Jr. on the front page of *The New York Times* of Feb. 7, "a new 'great debate' is raging" in Washington at the luncheon table and over the after-dinner coffee and brandy, and you'd be surprised to learn what it is about. Its "single idea" is that "the basic trouble with American society is that we devote too much of our resources to increasing an already affluent volume of private consumption, and too little to public services of all kinds." In sum: "There is something wrong with a country that has bigger and better tailfins at the same time that it has a second-best defense posture, a worsening slum problem, dirty rivers and streams, inadequate health services, and wretched underfinancing of education."

Before we take up the “single idea” we might go once over lightly a few of these detailed charges. Our defense ought to be as adequate as we can make it; but mere spending is not the whole answer. As for health services, both private and public, we are spending more on them than ever before in human history. The same is true of education. If the education of our children is wretched, it is not because we don’t pay enough for it. The real complaint in the foregoing paragraph is that people choose to spend their own money on automobiles instead of on better housing.

### STILL MORE SOCIALISM

The single idea of this so-called great debate, to restate it in plainer words, is that we do not have enough socialism and ought to have still more; that annual Federal expenditures at the rate of \$96 billion are not enough and ought to be enormously larger; that the tax burden ought to be still more crushing; that it isn’t enough to confiscate up to 91 percent of man’s income, the government ought to grab what is left; that the enormous Federal bureaucracy ought to be still further expanded; that people should not be allowed to spend the money they earn on the things they want, but on the things that the Lippmanns and Galbraiths think is good for them.

Paradoxically, the same people who are assumed to be incompetent individually to know how to spend their earnings are assumed to be competent collectively, as voters, to decide how the incomes of everybody else should be spent.

What a still greater tax burden will do to incentives and to the productivity of enterprise is a question that the welfare-state zealots do not consider. Production, they assume, increases automatically, regardless of incentives, the right of a man to buy what he wants or to keep what he earns, or the rewards to saving, risk-taking, or capital investment.

If Washington dinner parties are toying with the idea of a still deeper plunge into socialism, welfare-statism, bureaucratic rule, spending and taxing, their attention should be called to a few real problems. I suggest that the following subjects for possible great debates are being neglected:

1—The effects of continuous deficit financing and of continuously expanding government spending—particularly on nondefense items.

2—The effect of progressive income taxes rising to 91 percent, of corporate income taxes of 52 percent, and of the capital-gains tax in its present form, in reducing incentives and production and sometimes even reducing revenues.

3—The effect of our foreign-aid program in subsidizing foreign socialism, making enemies rather than friends, upsetting our balance of payments, and bringing increased taxes or deficits at home.

4—The effect of farm price-support subsidies in increasing taxes or bringing deficits, raising the cost of foodstuffs for city workers and rewarding people for not producing.

5—The constantly growing social-security program and our ability to carry the burden.

6—The growth of a huge bureaucracy with a vested interest in perpetuating foreign aid, expanding social security, etc.

7—The uncontrolled power of nationwide labor unions to paralyze industry and force continuous inflationary settlements.

8—The danger under present conditions of retaining the 4¼ percent government-bond-interest ceiling.

9—The threat to our gold reserves.

10—The mounting threat to the integrity of the dollar. ❁

## Whose Welfare State?

February 29, 1960

Former President Hoover has pointed out that Marxist thinking infects us and has even “got frozen” into the Eisenhower Administration. Senator Goldwater pleads with his Republican colleagues, in Human Events, to offer the American voter a clear-cut alternative to “the paternalistic superstate with its ever-increasing spending and its ever-increasing taxation and its ever-increasing interference in the life of the individual.” But Arthur Krock points out in the *New York Times* that the President’s sympathetic “consideration” of proposals for free hospital and nursing care of elderly citizens, to be paid for out of Federal revenues, is another Republican step toward the welfare state. The voters, he concludes, “will find it difficult to detect a basic ideological distinction between the two major parties.”

At present there is hardly a major field in which the voter can detect a significant party difference. Let us run through a list.

**Social Security:** All the social-security increases of the last seven years have been bipartisan. The President himself has insisted on bigger and longer unemployment benefits. True, there is a small party difference regarding the Senate’s \$1.8 billion aid-to-education bill, providing funds for both school construction and teachers’ salaries.

**Farm Subsidies:** The farm price support fiasco has become a national disgrace. In his message to Congress of Feb. 9, the President pointed out that \$3.5 billion of Federal funds are tied up in wheat alone (a crop which provides only 6 percent of cash receipts from sales of farm products). It is costing the government \$1.5 million a day, or more than \$1,000 a minute, just to store the wheat surpluses created by its own price policies. But the President does not dare to suggest termination of the program. He expresses a mild hope that price supports will be more “realistic” and controls fewer. He advocates an even greater “soil bank”—60 million acres.

**Foreign Aid:** Though this program was Democratic and Trumanic in origin, Mr. Eisenhower now pleads for more “economic” foreign aid than even Democrats seem willing to give. Most of this will go to subsidize socialistic programs (as in India) which can only slow down rather than accelerate economic progress in the receiving countries.

**Spending:** Average annual Federal *nondefense* expenditures, seven Truman years (1947–53), \$23.7 billion; average seven Eisenhower years (1954–60), \$27.3 billion. The President has asked for repeal of the legislative ceiling of 4¼ percent on long-term bonds, a ceiling which can now have dangerous inflationary consequences. A Democratic Congress has refused to act. But Mr. Eisenhower has certainly been less insistent than the situation warrants.

**Labor:** The Administration admonished the steel companies not to grant an inflationary wage increase; encouraged them to hold out during a costly 116-day strike; finally intervened in behalf of an inflationary wage settlement; yet did nothing and is doing nothing to revise laws that empower industrywide unions to choke off production until their demands are met.

**Hostility to Business:** The Administration charged 29 big oil companies with conspiracy to fix prices. A Federal District judge has now acquitted the companies, declaring that the evidence submitted by the government did not “rise above the level of suspicion.”

**Communism:** To the ideological warfare daily conducted against a free economic and political system by Communistic propaganda, the Administration has made feeble, sporadic, and apologetic replies. Even when, at our doorstep, Cuba expropriates American property and insults us, our government makes only a weak-kneed and perfunctory protest, and continues to subsidize Cuban sugar imports.

True zealots for the welfare state will prefer to have it run by original New Dealers. Unless traditional Republicans are made aware between now and

November of a real party difference, they will do what so many did in 1948—sit on their hands. ☸

## How to Curb Spending

March 7, 1960

Every January, since the passage of the Budget and Accounting Act of 1921, the President has been required to submit to Congress an estimate of the Federal government's expenditures and receipts during the next fiscal year. But the results have seldom corresponded with his estimates. In 1959, for example, actual expenditures were \$6.8 billion more than his estimate and receipts \$6.1 billion less.

The extent of these errors was unusual. What has not been unusual has been the tendency of expenditures to exceed the incumbent President's estimates year after year for the simple reason that the President in fact lacks the power to control the budget.

### SET UP FOR SPENDERS

Today the President, House, and Senate can all compete against each other in recommending or appropriating money to favored projects or groups. It is difficult to fix responsibility for the resulting extravagance or budget deficits. The strongest arguments against the wastes in farm subsidies, veterans pensions, foreign aid, or other programs are impotent against a system that seems precisely set up to favor the spenders.

We urgently need a responsible budget system in which the President and Congress are encouraged to compete with each other in economy rather than extravagance. This is not a utopian dream. Such a responsible budget system has existed for years in Great Britain. It has long prevailed in many of our own states. President Eisenhower, who asked in his Budget Message this year for power to veto individual items in appropriation bills, pointed out that the governors of 41 states now have this power.

But to attain a truly responsible budget system, the President should be granted even more power than this. He should have the power not only to veto any individual item in an appropriation bill, but any increase in any item beyond the amount first proposed by him in his Budget Message or in any special message. If Congress wishes to increase any appropriation beyond his recommendation, or to make any appropriation not recommended by him at all, it should be constitutionally required to do so in a separate bill subject to his veto.

There would be nothing extraordinary or unprecedented in such a grant of power. It is almost precisely



what is required in the constitutions of some of the states.

In New York, for example, the governor's annual budget must not only give estimated expenditures and revenues for the next fiscal year, but must be accompanied by a bill or bills containing all the proposed appropriations and any proposed new taxes. The legislature (I quote the state constitution) "may not alter an appropriation bill submitted by the governor except to strike out or reduce items therein. . . ." Further: "Neither house of the legislature shall consider any other bill making an appropriation until all the appropriation bills submitted by the governor shall have been finally acted on by both houses. . . ." If the legislature wishes to add any appropriation, it must do so by separate items or bills "each for a single object or purpose" which "shall be subject to the governor's approval." And the New York constitution gives the governor explicit power to do what the President cannot do—veto individual items in appropriation bills.

### STOP, LOOK, LISTEN

The late Senator Vandenberg, in advocating such power for the President in 1936, wrote in *The Saturday Evening Post*: "The item veto does not give the President one single additional, affirmative power. He cannot start anything as a result. He can only stop something long enough to focus the attention of the country on it, and long enough to force two-thirds of the House and Senate to agree to it in spite of him and his reasons, if they should persist in their adverse judgments. Its only harm, if any, would lie in the temporary delay while Congress and the country stop, look, and listen."

The basic principle to be followed to attain a responsible budget system is clear. It is to reduce the power of either Congress or the President to spend without restraint and to increase the power of both Congress and the President to limit the spending of the other. ❁

## Arms and the Budget

March 14, 1960

What is the truth about national defense? Are we spending enough on it? Are we spending it on the right things? When the experts contradict each other, whom are we to believe? Shall we dismiss all the criticisms of our defense program as inspired merely by partisan politics? Shall we put our faith implicitly in the President's judgment?

It is hard to find confident answers to all these questions. Few people can seriously believe that the

President would deliberately mislead the American people on a question crucial to our very survival. But the question remains whether he himself correctly estimates all the military possibilities, or whether he has not been misled into unwarranted optimism or placidity. Certainly, even when we have made allowance for the criticism inspired by partisanship or a drive for bigger appropriations for someone's pet project, we cannot dismiss *all* the criticism as either interested or uninformed. Too much of it has come from sources that compel respect, both for their motives and for their knowledge.

### ERRORS INEVITABLE

Part of the problem arises because no one mind has all the answers. Because of military secrecy, few of us are in a position to know even our own war capabilities; yet military secrecy is indispensable. Even the experts often do not know precisely where they stand. Will their next test missile firing, for example, be a success? And if the difficulties of estimating even our own capabilities are so enormous, what is to be said about our ability to estimate correctly the capabilities of the Russians? As errors are inevitable, they should be on the side of overestimating Russia's capabilities and underestimating our own.

The testimony of some of the experts is not reassuring. Oskar Morgenstern, in his recent book, *The Question of National Defense*, comes to the grim conclusion that "the probability of a large thermonuclear war occurring appears to be significantly larger than the probability of its not occurring." More than a year ago Albert Wohlstetter, in a sobering article in *Foreign Affairs* (January 1959) on "The Delicate Balance of Terror," underlined the crucial difference between the capability of striking by surprise and the capability of retaliating after being attacked between a "strike-first" and a "strike-second" capability. Deterrence is extremely difficult. It is not enough, but it is indispensable. "Almost everybody," Wohlstetter added, "seems concerned with the need to relax tension. However, relaxation of tension, which everyone thinks is good, is not easily distinguished from relaxing one's guard, which almost everyone thinks is bad. . . . To be tense where there is danger is only rational."

### NONDEFENSE WASTE

None of this means that we must simply surrender to the spenders and the inflationists. Defense is not measured by dollars spent but by weapons and safeguards provided. Suppose we find we ought to spend as much as \$3 billion more on certain weapons in 1961. It by no means follows that we must add this to present total spending, or even to total military spending.



New weapons nearly always make old weapons obsolete. Obsolete weapons and ways of spending can be discontinued. In any case, tremendous slashes are possible in nondefense spending, which is \$13 billion higher for 1961 than it was in 1954.

It is an easy patriotism that demands higher defense spending financed by budget deficits. This is merely to advocate that defense should be paid for by the invisible but no less real tax known as inflation. It is almost as easy to demand higher total spending financed by higher taxes, and to say with seeming courage that "we" must make greater sacrifices. This glosses over the question of *who* is to make the sacrifices. Our present tax system rests on the principle that it is precisely the most productive persons in the community who must be penalized the most. This principle obviously slows down economic growth. How about asking those who receive heavy subsidies for not planting crops, say, or others with vested interests in government handouts, to make the sacrifices? Are some of those who loudly demand more spending on armaments courageous enough to slash nondefense waste? ☸

## Sugar Can Turn Sour

March 21, 1960

For months Fidel Castro and his so-called government, in addition to waging a reign of terror at home, have been vilifying the United States, ostentatiously making deals with the Russians, seizing American property, and arresting American citizens. Our own government, in return, has not only restricted itself till now to a few perfunctory protests, but has continued to subsidize the Cuban economy.

The manner of this subsidy is complex. The United States assigns quotas to foreign suppliers of sugar. Omitting the special case of the Philippines, Cuba is allotted 96 percent of these foreign imports, and all other foreign countries together only 4 percent. With a quota of 3,120,000 tons this year, Cuba supplies a third of United States consumption, and receives a price of about 2 cents a pound above the world market. The differential is worth about \$150 million to Cuba this year.

The actions and slanders of Castro and his lieutenants reveal how little gratitude or good will we have got in return. Major Guevara, president of Cuba's National Bank, says that the premium the U.S. pays for Cuban sugar amounts to "economic enslavement." Presumably the highly publicized deal that Cuba made to sell Soviet Russia some sugar at 2.78 cents a pound

(about half the more than 5 cents paid by us and even below the world price of 3 cents) was a step toward economic liberation.

### EMERGENCY POWERS

Our own next step ought to be clear. Congress should immediately empower the President (whether he asks for the power or not) to reduce or terminate the Cuban sugar quota at his discretion, to stop paying anything above the world price to Cuba, or to raise the (now preferential) duty on sugar imported from Cuba to whatever figure he considered appropriate. These discretionary powers might be granted, say, for a period of a year. They would not necessarily result in any change in the sugar situation. But armed with these discretionary bargaining powers the President and Secretary of State would be able to negotiate with Castro more realistically and flexibly concerning his slanders and his seizures of American property. They would be able promptly to retaliate against hostile actions or promptly to reward more friendly actions. This they cannot do under the present rigid fixed-term quantitative quota system.

Such a grant of temporary discretionary powers vis-à-vis Cuba ought to be kept separate from the question of what the permanent revision should be of the Sugar Act, which expires at the end of this year. So far as that act is concerned, what is required is not a readjustment of quotas but a complete reappraisal of policy. The present complicated quota system goes back to the Jones-Costigan Act of 1934, followed by the Sugar Acts of 1937 and 1948, and the amendments and extensions of 1952 and 1956.

### COBWEB OF QUOTAS

There is hardly a pernicious economic or legal principle that is not embodied in these laws. The Secretary of Agriculture must determine each year the quantity of sugar "needed to meet the requirements of consumers." He must divide the U.S. sugar market among domestic and foreign supplying areas by the use of quotas. He must allot these quotas among individual domestic producers. He must levy a tax on the processing of sugar cane and sugar beets and use the proceeds to make payments to producers to compensate them for adjusting production to marketing quotas. He must prescribe an "equitable" division of sugar returns among processors, growers, and farm workers.

The result is an economic regimentation and complicated nightmare of controls unparalleled even in the rest of our farm program. It involves rigid and discriminatory treatment of all foreign exporting nations, tends to breed resentment in all except the most favored, Cuba and is now treated scornfully in Cuba itself. This

is a heavy price to pay to subsidize a combined domestic beet and cane production equal to only about one fourth, and a domestic cane production equal to only about one-fifteenth, of our total sugar consumption.

It is high time to start extricating ourselves from the whole fantastic sugar quota program. ☸

## Foreign Aid Run Riot

March 28, 1960

A subcommittee of the House, in reporting on a 40,000 mile study mission around the world has concluded that the U.S. foreign-aid program is attempting to underwrite too many projects, some of them grandiose and too costly, and that money spent on foreign aid is a growing strain on this country. Many previous committees and observers have come to the same conclusions. Yet it is significant that this latest report, like its predecessors, accepts as a matter of course the *principle* of government-to-government foreign economic aid. This is why such aid not only continues but grows, under ever-different names, with no stopping point in sight. In *Newsweek* of Nov. 16 last I discussed the proliferation of agencies and of postwar foreign loans and grants totaling some \$70 billion.

For the next fiscal year the President has asked Congress to provide \$4.2 billion in foreign aid, of which \$2 billion would be military and the rest “economic” assistance. It is proper that the request should be divided in this way. Military aid can be justified in principle. It is clearly needed in Korea and Taiwan, which have demonstrated their own willingness to resist aggression. But this does not mean that any aid called military should be immune from challenge. Much of it becomes extremely dubious when 50 recipients are involved.

### DO WE GET DEFENSE?

Moreover, American aid that goes to make up a budget deficit ostensibly caused by military expenditures of the recipient may in fact be paying for larger nondefense expenditures than otherwise. When American taxpayers pay for any category of Ruritania’s expenditures, Ruritaniens have that much more of their own resources left to spend on something else. This substitutability of resources (unless we undertake to control every item of a foreign government’s expenditures and taxes!) is ignored by the administrators of foreign aid, “military” or “economic,” when they solemnly approve hundreds of special “projects.”

Though the President’s foreign-aid message of Feb. 16 contained some 5,000 words, he did not find space to specify there how many nations and governments the American taxpayer was aiding or being asked to aid, how much we had already spent on this program, how much it was going to cost in future, and when it was going to stop, if ever. Instead, Congress was told in sweeping generalities that it is somehow the duty of the American taxpayer “to raise the standards of living of millions of human beings” all over the world, and that government economic aid is the way to do it.

### SUPPORTING SOCIALISM

Both propositions are doubtful. To undertake to lift the living standards in every backward nation, especially with no control over the policies of that nation, is to assume a bottomless and endless responsibility. And government aid retards, instead of promoting, true economic progress.

The situation was bad enough when we gave aid to a score of nations, on the plea of “no strings attached,” regardless of whether or not they dissipated that aid in “directed” economies and in socialization. We now explicitly endorse socialized planning. We apparently even make it a *condition* of eligibility for aid. In his message of Feb. 16 Mr. Eisenhower spoke approvingly of “an expanded and accelerated program of economic reform and development” for Nationalist China. In a speech in Puerto Rico on March 4 he said that though “the United States alone” should not develop “a so-called master plan for the raising of living standards through the hemisphere . . . each nation of Latin America . . . must analyze its own human and material resources and develop a program of action with priorities assigned. Then national and international credit agencies should stand ready to be of assistance in making the program a reality.”

The dirigistic and socialistic assumptions underlying the foreign-aid program are daily becoming more unmistakable. The sponsors of the program have completely forgotten, if they ever knew, that the soundest economic growth, either at home or abroad, comes when private capital, protected from arbitrary seizure or harassment, is free to flow to the enterprises that best promise to meet consumer demand. ☸

## Backward Step

April 4, 1960

Because the Landrum-Griffin bill, in the form in which it passed the House, contained some unexpected curbs

on labor-union power, many conservatives hailed its final passage as a great victory. But Sylvester Petro, professor of law at New York University, in the most realistic analysis that I have yet seen, contends in the *National Review* of March 26 that the new law “fails to remove existing shortcomings in labor relations or to alleviate even the more glaring defects in labor legislation.”

Few persons seem to realize how important the changes were—“all for the worse”—in the bill that emerged from the conference committee of the House and Senate. Those changes were apparently made at the suggestion and insistence primarily of Senator Kennedy and his legal advisers, principally Prof. Archibald Cox of the Harvard Law School. Professor Petro thinks it appropriate to call what emerged “The Kennedy-Landrum-Griffin Law,” a name which he shortens to K-L-G.

### BAD LEGISLATION

It is, of course, impossible here to discuss all the details of K-L-G, but Petro finds it, on the whole, bad legislation, both in terms of what it does and what it does not do.

It is legal in most states for unions to force employers to agree to closed shop and union-shop contracts; K-L-G secures the right of unions to exercise these restraints. By a perversion of the majority-rule principle, unions have the privilege of putting themselves forward as exclusive bargaining representatives even for unwilling employees. The minority are denied the right to make their own employment contracts. The exclusive bargaining principle is a special privilege which unions alone enjoy. K-L-G accepts this principle.

In the recent Albert Lea strike of Minnesota, Governor Freeman closed a plant until the courts intervened because a union was resorting to violence against workers who were crossing its pickets in order to go to work. “This kind of privileged crime,” writes Petro, “can only be coped with when we take the honest and courageous step of prohibiting all mass picketing, by applying existing laws against coercive picketing.” K-L-G says nothing about this.

K-L-G does nothing, either, to curb the so-called pre-emption doctrine, contributed by the Supreme Court, which practically holds that, because Congress has “pre-empted” the field, the states no longer have the power to regulate labor relations within their own boundaries. And K-L-G is an ineffectual counter to anti-injunction laws “which make it almost impossible for persons seriously injured by unlawful union conduct to secure the immediate injunctive relief which is in many cases the only relief that is of any use at all.”

### PICKETS AND BOYCOTTS

K-L-G devotes a great deal of complicated language to picketing and boycotts. Yet instead of prohibiting “stranger-picketing,” which is generally conceded to be coercive, it explicitly authorizes it under certain conditions for 29 days. K-L-G reverses “one of the healthiest and most significant principles of the Taft-Hartley Act.” This was the declaration that permanently replaced strikers were not eligible to vote in future representation elections in the units in which they were no longer employed. Under K-L-G, replaced strikers can vote for a year after the strike has been called. K-L-G, finally, by dealing in detail with the internal affairs of unions, establishes the dangerous principle of Federal supervision of private associations.

What should have been done instead of passage of the Kennedy-Landrum-Griffin Law is clear. On the one hand, there should have been removal of the special privileges given to trade unions by present law. On the other hand, there should have been enforcement of the basic laws of the land against union violence and coercion.

But because of the new law, the politicians can pretend that at least something has been done toward solving the labor problem, and can ignore that embarrassing issue completely in an election year while busily discussing “civil rights,” subsidies for Federal school construction, and medical aid for elderly voters. ❁

## Tying Its Own Hands

April 11, 1960

In the last two or three months there has been a sharp fall in interest rates. As a result it is being frequently said in Washington and in press that the U.S. Treasury's efforts to get Congress to remove the statutory limit of 4¼ percent on long-term government bonds have become altogether futile; that the proposed legislation is in “indefinite eclipse,” and that the whole dispute has become “pointless.” But before we so hastily bury the issue it might be wise to ask if it is really dead.

It is true that a few months ago some long-term Treasury issues were selling at prices to yield about 5 percent and that within recent weeks some have been selling to yield less than 4¼ percent. It is true that the government's 91-day bills, which sold at rates to yield 4.75 percent in early January, have recently been put out at yields of only 2.79 percent.

The need for Congressional action *looks* less urgent than it did a few months ago. But it remains no less



important. It would be, in fact, dangerous for Congress to postpone it. In the recent high interest rates Congress got an unmistakable warning. It will have to bear full responsibility for the consequences if it ignores that warning. President Eisenhower raised the issue in a message as early as last June. It became more urgent after he raised it. If interest rates can fall unexpectedly they can also rise unexpectedly. The latest issue of long-term bonds that the Treasury attempted—the 4 percents of 1969, put out in 1957—rose to 110 to yield about 2.94 within a year of their sale. Less than two years after that they had declined to about 94, at which their yield was 4.71 percent.

### WHY KEEP IT?

Instead of asking what need or point there is in removing the statutory interest rate ceiling, we should be asking what need or point there is in keeping it. If the ceiling were repealed, no harm whatever would follow. It would not in the least increase the interest rates the government would have to pay. The Secretary of the Treasury, as now, would not try to borrow at the highest rates possible but at the lowest rates possible, in accordance with his plain duty.

But though the statutory ceiling does no good, it retains great possibilities for harm. Last week the Treasury felt obliged to offer the  $4\frac{1}{4}$  percent ceiling rate for new bonds. When interest rates on government long-term bonds are above  $4\frac{1}{4}$  percent, it forces the Treasury to borrow at short-term (less than five years). This leads to congestion in the market for short-term securities, forces up interest rates on such securities, tends to raise the average rate at which the government can borrow, and prevents the Treasury from achieving a manageable balance in maturities.

### PRESCRIBING INFLATION

Two issues are involved here—the administrative and the economic. The administrative issue is whether the terms, maturities, balance, timing, and interest rates of 50 or more different issues of government securities should be determined by Treasury experts, in daily touch with the money market, or whether these decisions should be prescribed blindly and far in advance by a lay Congress concerned with a hundred other matters. The  $4\frac{1}{4}$  percent ceiling on long-term government bonds was written into the law more than 40 years ago. Fortunately for us now, that ceiling was not imposed, as it consistently might have been, on short-term as well as long-term borrowing. Fortunately, also, by historic accident, the statutory ceiling we now have is the  $4\frac{1}{4}$

percent imposed in 1918, and not the  $3\frac{1}{4}$  percent earlier fixed by Congress in 1917.

Administratively, it is folly for the government to tie its own hands. But the economic case against the ceiling is even more serious. The only way interest rates can be arbitrarily held down to the ceiling (even temporarily) is by an increase in the money supply, either directly, or indirectly by forcing the Federal Reserve Banks to return to the pegging of interest rates by buying government bonds and monetizing the national debt. In effect, this is what Senator Douglas and his Congressional committee have been proposing. The failure of Congress to remove the ceiling now can only undermine confidence in the dollar both at home and abroad. ☼

## Cheap Money Is Dear

April 18, 1960

The word from Washington is that as a result of the success of the Treasury in selling some long-term government bonds at the legal ceiling rate of  $4\frac{1}{4}$  percent, no action is likely to be taken to repeal or even modify the ceiling in this session. Such a failure to act would be irresponsible. Retention of the old legal ceiling would do no good, and might do incalculable harm.

There is no reason to suppose that the legal interest ceiling in itself saves the government a single dollar in interest costs. It is the plain duty of the Secretary of the Treasury to borrow at the lowest rates, at the smallest costs in the long run, that the market allows him to get. If we ever had a Secretary who was not willing to do that, or not competent to do it, the  $4\frac{1}{4}$  percent legal ceiling on long-term bonds would be futile anyway; for the Secretary can borrow at any rate he chooses on securities with less than five years to run.

Last week I pointed to the administrative folly of retaining a 42-year-old prohibition that today simply ties the hands of the Treasury experts, in daily touch with the market, and prevents them from exercising their best judgment concerning what length maturities to offer. It forces them to glut the market for short-term securities, and raises the average rate at which they can borrow. But the economic folly is much more serious, and deserves longer examination.

### CHEAP MONEY INFLATES

A policy of cheap money (i.e., a policy of arbitrarily keeping interest rates down) is only another name for a policy of inflation. The only way interest rates can be held down even temporarily to an arbitrary ceiling is



by an increase in the money supply. This increase may be achieved by a direct resort to the printing press. It may be achieved by a return to the policy of forcing the Federal Reserve banks to buy at the predetermined low interest rate all the government bonds offered. The Fed would pay for these either by creating deposits or printing notes against them. This is what is known as monetizing the national debt.

Instead of reducing or holding down interest rates by increasing the supply of money and credit, we may increase the supply of money and credit by reducing interest rates. Low interest rates encourage borrowing at the banks. Other conditions being unchanged, more projects will be undertaken and more money will be borrowed at 4 percent than at 5, or at 3 percent than at 4. When the banks lend, they create deposits against the loans; that is, they in effect create new money. Low interest rates are inflationary when they lead to an undue increase in the money supply. Conversely, the only way interest rates can be held down below the "natural" rate at any time is by an increase in the money supply.

#### WHAT HAS IT COST?

This inflationary cheap-money policy cannot be kept going indefinitely. The consequent increased number of dollars, of course, cheapens the dollar in terms of goods. In other words, there is a rise in prices. As a result, cheap money eventually costs the government far more in total dollar expenses and interest charges than "tight" money would have cost it. Further, if the inflation and the rise in prices is expected to continue, lenders will begin to insist on a higher interest rate as a sort of insurance premium against depreciation in the value of their loaned dollar capital.

The irony is that it is precisely the people in Congress who are now protesting loudest against "high" interest charges whose policies in the past have done most to raise those charges. It is their spending policies and deficit financing policies that have built up a Federal debt of \$287 billion and an annual interest charge of \$9.4 billion.

Whether or not Congress now votes to repeal the legal 4¼ percent ceiling on long-term government bonds is no mere technical matter, of interest only to experts. It may be a fateful decision. It may crucially affect confidence in the dollar at home and abroad. A failure of Congress to repeal at this session may prove, in effect, a vote for inflation. If the Democratic leaders in Congress make that decision, they must bear full responsibility for it. ☸

## Age, 'Needs,' and Votes

April 25, 1960

"One of the most intensive and broadly based lobbying operations in recent history has made health insurance for the aged easily the No. 1 issue before Congress this year." So begins a *New York Times* news story describing the tremendous campaign to promote the Forand bill. The propaganda and pressure are skillfully organized and timed. They are backed by the Americans for Democratic Action, by Walter Reuther and the Committee on Political Education of the CIO-AFL, by Senator Kennedy, who has introduced a companion in the Senate to the Forand bill in the House, and by a group of columnists who have begun suddenly and as if on signal to wail and weep in chorus about the plight of the aged. Anybody who doesn't immediately join up is denounced as heartless and cruel. We are back in the revivalist atmosphere of the Townsend Plan of 25 years ago though today \$16 billion a year is already being spent on old age and other OASI programs.

#### THE FORAND BILL

The Forand bill would add hospitalization and surgical insurance to the social-security program. It would profess to pay for this addition out of an increase in the OASI tax of ¼ percent on the employee and ¼ percent on the employer. Actuarial estimates by the insurance industry are that costs under the Forand bill would range from \$2 billion to \$2.4 billion for the first year, and, by 1980, from nearly \$6 billion to more than \$7.5 billion a year. This would require a level premium not of ½ percent, but of 2.32 to 2.97 percent of taxable payroll. Social-security taxes are already scheduled to reach 9 percent of payroll by 1969, without any Forand bill, and in later years to soar 11 to 16 percent of payroll.

These and similar facts were brought out in the brilliant speech in the *Congressional Record* of March 24 by Congressman Thomas B. Curtis of Missouri. At what point, asks Curtis, will the taxpayers rebel? Some of them are now paying more in social-security taxes than they pay in income taxes. The Forand bill has been supported by grossly misleading statistics concerning poverty and need. In any case it would deny benefits to the 4 million aged persons who, through no fault of their own, do not have social-security protection.

There are much deeper criticisms. In 1949, Edna Lonigan, in a pamphlet published by the American Enterprise Association, pointed out how, since 1933, there had been a constant expansion of the concept of the "needy": "A zealous staff in a public welfare agency can find unlimited opportunities to add to the number of 'needy' families . . . and to the number of 'needs'

which must be met by the public through taxes." The last decade, with social-security "liberalization" in every election year, has confirmed that thesis.

### SOCIALIZED MEDICINE

The Forand bill is a foot-in-the-door for a complete program of socialized medicine. Walter Reuther testified last July: "It is no secret that the UAW is officially on record as backing a program of national health insurance." After this new aid to people of 65, people of 62 and 63 would want it. Then it would be argued that the medical needs of families with growing children were no less urgent. Finally everyone would be covered.

Socialized medicine is based on compulsory, not voluntary providence. Social "insurance" is a misnomer; individual benefits bear little relation to the individual tax. It is a program for the redistribution of income. The young will have to accept less than they produce in order that the old can get more than they produce. Pressure will build up for reducing an insupportable burden on the young by an inflation that reduces the real benefits of the aged. It is those who today weep most ostentatiously over the plight of the aged who are mainly responsible for the inflation that has already cut the purchasing power of their pensions in half.

"Security" can come only out of production. The policies of the welfare-statists penalize and discourage production. As Bastiat pointed out more than a century ago: "The state is the great fiction by which everybody wants to enrich himself at the expense of everybody." ❁

## Years of Inflation

May 2, 1960

In this space nearly ten years ago (*Newsweek*, Sept. 17, 1951) I ran a chart comparing the increase in the cost of living, in wholesale commodity prices, and in the amount of bank deposits and currency, from the end of 1939 to the middle of 1951. This chart was incidental to pointing out that the rise in living costs and prices was the result of the increase in the supply of money and credit, and not of a "shortage of goods" or a so-called "cost push."

We are now in a position to compare the same three items over a full twenty years, from the end of 1939 to the end of 1959. The accompanying chart gives us a panoramic view of the inflation during that period. It shows that, while consumer prices increased 113 percent between the end of 1939 and 1959, wholesale prices increased 136 percent in the same period and the total

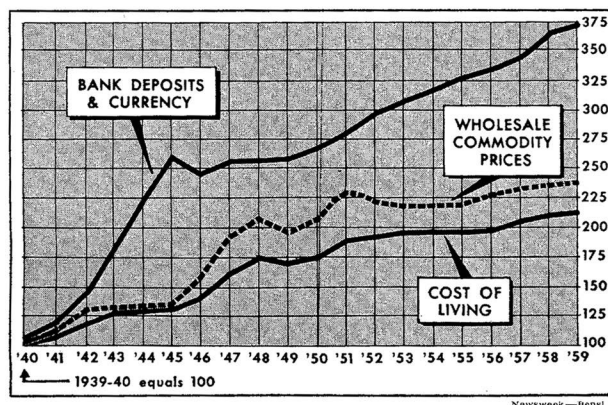
supply of bank deposits and currency increased 270 percent.

If we are to adopt the proper measures, the only effective measures, to halt inflation and prevent its resumption, we must clearly recognize that its basic cause is the increase in the supply of money.

Two rival theories still persist. One is that inflation and rising prices are caused by a "shortage of goods." The figures refute this on their face. The official index of industrial production was 177 percent higher in 1959 than in 1939; in other words, the rate of production of goods was almost three times as great. It was in spite of this enormous increase in productivity that wholesale prices increased 136 percent—i.e., more than doubled—during the period. In other words, the increase in the money supply would have caused an even greater rise in prices if it had not been offset by an increase in the supply of goods. While the production of goods almost tripled, the supply of money and bank credit almost quadrupled.

### MONEY VS. 'COST PUSH'

The other rival theory is that inflation and the rise of prices are caused by higher wage demands—by a "cost push." But this theory reverses cause and effect. "Costs" are prices. An increase in wages above marginal productivity, if it were not preceded, accompanied, or quickly followed by an increase in the supply of money, would not cause inflation; it would merely cause unemployment. It is not true, as so often assumed, that a wage increase in a given firm or industry can be simply "added on to the price." Without an increased money supply, prices cannot be raised without reducing demand and sales, and hence production and employment. We can stop the "cost push" if we halt the increase in the money supply and repeal the labor laws that confer irresponsible private powers on union leaders. ❁



## Subsidizing Socialism

May 9, 1960

Ever since the advent of the New Deal, socialist assumptions have tended increasingly to supplant capitalist assumptions in our thinking. Nowhere has this change been quite as marked as in foreign economic policy.

The whole foreign-aid program, outside of purely military aid, rests on socialistic assumptions. The quickest and healthiest way to economic growth, which will tend to supply soonest the goods that consumers most need, is the way of free enterprise. The first duty of the government of an undeveloped country (as of a rich and “developed” one) is to make its country as attractive for private investment, domestic or foreign, as it possibly can.

This means that it must assure a sound and stable currency to protect savers against inflation. It must restrict itself to prudent spending, to remove any need for burdensome taxation. It must not discriminate against foreign investors or harass its own businessmen. It must refrain from price-fixing, wage-fixing, and exchange controls, so that foreign investors are free to convert or withdraw their earnings at all times. Above all, it must not socialize or expropriate industry or property or threaten to do so. It must respect property rights at all times.

### UNATTRACTIVE FIELD

In the main we followed such policies in our own early history and attracted British capital that greatly increased our rate of expansion. Canada in the main follows such policies today and has attracted billions of U.S. private investment. The great majority of “underdeveloped” countries today fail to follow anything like such policies. That is why they are so unattractive a field for private capital, foreign or domestic.

Foreign aid does not cure this situation. It aggravates and prolongs it. As long as foreign governments can get the capital they want from our government without adopting any of the policies or giving any of the assurances that private capital would properly insist on, they will not adopt these policies or give these assurances. So long as we do not insist on these policies (and are even afraid to do so for fear of “dictating” or “attaching strings”) our aid subsidizes and prolongs socialism and retards real economic growth.

Today we are actually making state “planning” or socialism a *condition* for the receipt of our foreign aid. Six weeks ago I called attention to the remarkable endorsement by President Eisenhower of socialized planning for Nationalist China and Latin America.

On April 20 Secretary of State Herter went even further, and declared that the problem of land distribution should have the “urgent attention” of the Organization of American States.

### ‘LAND REFORM’

Now the Secretary should know that in the last twenty years so-called “land reform” in a score of nations has been commonly an accompaniment of socialization or communization. In most cases it has been a euphemism for expropriation, a fancy name for seizure. A typical procedure has been for the state to take over properties at a fraction of their market value and to pay even this sum in government bonds that would sell for only a fraction of their nominal value. What foreign countries do about their land problem is none of our business except when they expropriate American holdings. Then it is our plain duty to protect the lives and property of our citizens abroad. The Secretary’s statement may indicate why our protests against Castro’s seizures have been so feeble and perfunctory.

Another recent declaration of the State Department was revelatory. It declared that the picketing of the Egyptian ship *Cleopatra* by seamen in New York was “embarrassing” the conduct of United States foreign relations, but added that it recognized “the special status afforded to labor union picketing in labor disputes.” This “special status,” unfortunately, does exist under the Norris-La Guardia Act. Under the pretense of protecting “free speech,” this makes union members a privileged class, with the right to picket in mass, to intimidate and menace, to block entrance and exit—in short, to use private coercion. It is certainly “embarrassing”—and unconvincing—for our government to explain that it has stripped itself of the power to prevent this. ☸

## Inflation vs. Morality

May 16, 1960

Last summer (*Newsweek*, July 27, 1959) my colleague Raymond Moley wrote a column called “Inflation, a Moral Issue.” This ought to be the leading issue in the election.

Inflation never affects everybody simultaneously and equally. It begins at a specific point, with a specific group. When the government puts more money into circulation, it may do so by paying defense contractors, or by increasing subsidies to farmers or social-security benefits to special groups. The incomes of those who receive this money go up first. They begin to buy at the old prices. But their additional buying forces up prices. Those whose money incomes have not been raised are



forced to pay higher prices than before; the purchasing power of their incomes has been reduced. Eventually, through the play of economic forces, their own money-incomes may be increased. But if these incomes are increased either less or later than the average prices of what they buy, they never fully make up the loss they suffered from the inflation.

Inflation, in brief, essentially involves a redistribution of real incomes. Those who benefit by it do so, and must do so, at the expense of others. The total losses through inflation offset the total gains. This creates class or group divisions. The victims of inflation resent the profiteers from inflation. Even the moderate gainers from inflation envy the bigger gainers. There is general recognition that the new distribution of income and wealth that goes on during an inflation is not the result of merit, effort, or productiveness but of luck, speculation, or political favoritism. It was in the tremendous German inflation of 1923 that the seeds of Nazism were sown.

### SPECULATION VS. WORK

An inflation tends to demoralize those who gain by it as well as those who lose by it. They become used to "unearned increment." They want to hold on to their relative gains. Those who have made money from speculation prefer to continue this way of making money to the former method of working for it. I remember once, early in 1929, a conversation between two friends, both of whom held prominent posts as book reviewers but both of whom were heavily in the stock market. They were exchanging stories about their profits. "Today your salary," they agreed, "is just a tip." People do not like to work full time just for a tip. The trend in an inflation is toward less work and production, more speculation and gambling.

The profiteers from inflation tend to spend freely, frivolously, and ostentatiously. This increases popular resentment. The incentive for ordinary saving, in the form of savings bank accounts, insurance, bonds, or other fixed-income obligations, tends to disappear. The spectacle of quick and easy returns increases temptation to corruption and crime.

### 'A JUGGLING TRICK'

It is not merely that inflation breeds the gambling spirit and corruption and dishonesty in a nation. Inflation is itself an immoral act on the part of government. When modern governments inflate by increasing the paper money supply, directly or indirectly, they do in principle what kings once did when they clipped the coins. Diluting the money supply with paper is the moral equivalent of diluting the milk supply with water. For notwithstanding all the pious pretenses of governments

that inflation is some evil visitation from without, inflation is practically always the result of deliberate governmental policy.

This was recognized in 1776 by Adam Smith in *The Wealth of Nations*. Though I have quoted the passage before, it bears repeating: "When national debts have once been accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid." There is either "an avowed bankruptcy" or "a pretended payment."

The pretended payment was inflation. The U.S. Government today is paying off in 47-cent dollars the debts it contracted in 1940. Adam Smith went on: "The honor of a state is surely very poorly provided for, when, in order to cover the disgrace of a real bankruptcy, it has recourse to a juggling trick of this kind, so easily seen through, and at the same time so extremely pernicious." ❁

## The Big Brother State

May 23, 1960

More and more cynically, as the years go on, the social-security program is used as a political football. It is assumed that the votes of our older citizens are for sale to the highest bidder. Democrats suddenly push the Forand bill, openly for votes. The Administration, in panic, hastily slaps together a "substitute."

I discussed the Forand bill in this place in *Newsweek* of April 25. In the same issue there was a special report of three pages on the measure. The report showed that a husband who began paying at the start of collections in 1937, when he was 42, and who retires this year at 65, has paid \$1,100 in "premiums" but stands to get back an average of \$30,000. Actuaries have figured that a maximum payment from 1937 to the end of 1959—\$1,146—would actually finance a pension for a male at age 65 of about \$7 a month.

Yet the 10 million people who are getting present windfall payments are treated as if they had somehow been victimized. Though a token increase in taxes would be placed by the Forand bill on people still working, those already receiving old-age pensions, who have not made even nominal contributions for medical care, would be entitled to receive medical benefits immediately.

### DISGUISED RELIEF

The Administration bill was thrown together in haste. It is called "insurance," but it is mere additional relief.



Its benefits would be available free to elderly persons already on relief. Other elderly persons could get them, on payment of an annual fee of \$24 each, provided their income did not exceed \$2,500 a year for a single person or \$3,800 for a married couple. The limitation imposed on the income of persons eligible shows that the Federal government has not the slightest belief that \$24 would pay for earned insurance. That sum merely entitles the holder (because of his low income) to medical relief. The scheme would probably cost far more than the estimated \$1.3 billion a year.

The best thing that could happen in this session of Congress would be for the various Democratic and Republican bills to kill each other off.

Then there would at least be opportunity for some new Advisory Council on Social Security (like that of 1937) to study the issue of medical care for the aged and to re-examine the whole social-security program.

The original social-security legislation was economically unsound. In spite of this, it has been "liberalized" substantially, apart from earlier expansions, in every election year—1950, 1952, 1954, 1956, and 1958. Not only are the benefit payments constantly raised, but new "needs" are constantly being discovered and provided for—first benefits for old age then for dependents, then for survivors, then for disablement, and now for medical care.

#### **PSEUDO 'INSURANCE'**

Old-age "insurance" was originally enacted on the argument that it would do away with old-age relief. Yet Federal grants for old-age relief alone have grown from \$247 million in 1939 to \$1,880,000,000 in 1959. W. Rulon Williamson, the first actuary of social security, has pointed out that the benefits paid out under OASI in 1959 were ten times the benefits of 1950 and 10,000 times the benefits of 1937, the first year. Yet the total tax income has only reached seventeen times that of the first year.

That tax income is still inadequate. Williamson estimates that the unfunded accrued liability of the system may exceed \$650 billion. It is neither on a sound actuarial basis nor on a sound basis in relation to need. The benefits to the most affluent are three times as great as those to the minimum qualifier.

Instead of recklessly piling on new benefits, it is time to stop, look, and listen. The social-security system cries out for reexamination. It does not add to the supply of goods and services; it merely operates to redistribute income. In fact it lowers national output by encouraging premature retirement and limiting allowable earnings.

It cheats its supposed beneficiaries by forcing inflation and reducing the purchasing power of their pensions.

A leap into "medicare" may be a leap into socialized medicine; and a leap into socialized medicine may be a leap into the Big Brother State. ☸

## **Fruits of Appeasement**

May 30, 1960

Grave as it is, the present international crisis has compensations. It can teach valuable lessons, if we still have time and wit to learn them.

It was unfortunate that a U-2 was downed 1,200 miles inside Russia. But as a result we now know that these planes have been flying over or deep into Russia for four years, that Russia has not previously had the equipment to detect them and bring them down, and that the piloted bomber is not obsolete. As Hanson Baldwin has put it: "It is safe to conclude that the Soviet air defenses today could not possibly fend off a major assault by SAC." In short, our striking power is greater and Russian defensive power weaker than had been supposed.

This does not mean that Russia may not still have a substantial lead in long-range missiles. It is still true that our government, and the President, have made practically every diplomatic mistake in the book. It was a mistake to deny that the U-2 was on an espionage mission. It was an even bigger mistake to admit it, particularly after the denial. It was right to stress the need for such reconnaissance, but a mistake to do so without, at the same time, reciting Khrushchev's open threats to bury us, and the whole appalling record of Soviet espionage. It was a mistake to imply that we would continue espionage flights. It was then a greater mistake to promise to stop them. This record of blundering, denial, confession, reversal, and retreat has done incalculable harm to our moral prestige.

#### **THE ROOT ERROR**

But beneath all the errors of the last few weeks has been the root error of our whole policy vis-à-vis Russia over the last fifteen years. From the very beginning, when we agreed to accept a militarily untenable position in Berlin, we have followed toward the Russian despots the same policy of appeasement, concession, acquiescence in insults and humiliation that Britain followed so disastrously toward Hitler.

Pressure to follow this policy has come continuously from the political left. Though Khrushchev, like Stalin, has successively broken every promise and treaty the

moment it suited his ends to do so, though he feigned troop withdrawal from Hungary merely to give himself time to bring in more tanks to machine-gun patriots in the streets, we have been urged to negotiate with this monster as if he were a man of good faith, as if his word or his signature were worth something. The slogan of our appeasers has been “relaxation of tensions,” which, as Albert Wohlstetter has pointed out, is hard to distinguish from relaxing one’s guard.

### END OF A DREAM

That we are all tense again is, in view of the actual threat we face, not a loss but a gain. We have been saved from a worthless agreement at the summit conference which might have caused us to live in a fool’s paradise while Russia built up for a devastating surprise attack. We should never have agreed to a summit conference. However we may try to disguise the matter, we agreed to that conference under the threat of Khrushchev to kick us out of Berlin. We should simply have told him we were there in accordance with our occupation rights and there was nothing to discuss. We could have told him that if he had any peaceful proposals to make our Ambassador in Moscow had plenipotentiary powers to discuss and convey them. We could have told him that if he wanted to relax tensions he could do so by a few simple deeds or restraints from deeds.

Let us hope that we are through with our summit-conference dreams. Our appeasement has only encouraged Khrushchev to recklessness. Let us at last launch a real propaganda counteroffensive of our own. Let us expose the nonsensical claims of Communist “economic growth” instead of swallowing them whole. Let us have the courage to defend capitalism, to explain the superiority of economic freedom. Instead of trying to call off the cold war, which we can’t, let us recognize at last that it is being relentlessly fought against us, by an enemy determined on world conquest; and that our only hope of peace and security is to accept the ideological challenge and to seek not a truce but a victory. ❁

## Growth of What We Owe

June 6, 1960

Our national debt is \$289 billion. If there were any serious thought of ever paying this off, even in dollars of today’s buying power, it would present an appalling problem. If we could pay off an average of \$2 billion every year, without interruption, and never incur another cent of debt, it would still take nearly a century and a half to wipe the slate clean.

Precisely because there is always danger of another war, it is merely common prudence and common sense to reduce the debt in time of peace or even cold war so that our national credit will be strong enough to meet the incalculable borrowing demands of a shooting war. Yet instead of reducing the debt in the fifteen years since the end of World War II, we have increased it, through deficits, by an average of \$2 billion a year, so that it now stands \$30 billion higher. And whenever the President talks of balancing the budget, not to speak of reducing the debt, he is accused of putting dollars and mere bookkeeping ahead of national needs.

### HEAVY EVEN FOR US

Why is the debt problem treated so lightly? Probably the most frequent argument is that we are the richest country in the world, and can afford it. But the debt of the United States is one of the heaviest in the world *even in proportion to our total wealth and resources*.

I append below a table comparing the public debt of fifteen leading countries with the latest available figure of their annual tax revenues. The figures for the U.S. are for the current fiscal year. The figures for other countries are from the *Statistical Yearbook of the United Nations* for 1959. A few are for the 1959 fiscal year, and others earlier. The comparisons are in billions of the respective currencies of each country, except for France, Italy, and Finland, where they are in trillions. The figures in terms of currencies are therefore not comparable as between countries. What is significant and comparable is the percentage of each country’s debt to its own annual income from taxes. This I have calculated in the final column.

It will be seen that the U.S. public debt is not only by far the greatest in absolute terms but one of the heaviest even in relation to revenues.

It should not be assumed that the countries with the heaviest relative national debts are more blameworthy than others. The debts of the three great English-speaking countries are relatively highest not only because they were engaged in a great world war but because they have not reduced their relative debts to the same extent as some others by the swindling device of monetary inflation. But the comparisons do mean that their debt problem is still greater relatively than that of most other countries.

In fact, the relative debt burden of the United States is much greater than these comparisons imply. A year ago Secretary of the Treasury Anderson placed before the Senate Finance Committee a list of the long range commitments and contingent obligations of the Federal government *in addition to* the direct public debt. This total of contingent obligations alone came to \$316 billion, or more than the direct debt itself. As

The Morgan Guaranty Survey for May has pointed out, these contingent obligations are “a massive commitment of the public credit.” And in addition even to these \$316 billion contingent obligations, our social-security program already involves a future actuarial liability running into hundreds of billions.

#### DEBT VS. REVENUES

Nation	Public Debt	Government Revenue	% of Debt to Revenue
United Kingdom (£)	27.5	5.6	490
Canada (\$)	20.2	4.6	438
United States (\$)	288.6	78.6	367
Spain (pesetas)	113.4	37.2	305
Philippines (pesos)	1.9	1.0	190
Turkey (lire)	7.4	4.0	188
France (fr.)	7.0	4.2	169
Switzerland (fr.)	4.7	2.8	168
Portugal (escudos)	11.7	7.1	164
Italy (lire)	5.1	3.1	162
Denmark (kr.)	9.0	5.7	158
Sweden (kr.)	18.4	12.7	144
Norway (kr.)	8.3	5.8	143
Germany (marks)	22.2	31.6	70
Finland (markkaa)	.17	.29	59

To add lightly to this liability now, by hastily passing a “medical care” bill for the aged, would be an act of reckless folly. ☸

## Insurance Or Handout?

June 13, 1960

Politicians are very generous in “doing something for our senior citizens,” but none tells us at whose expense. The only merit of the Forand bill is that it emphasizes how flagrantly “social security” has been turned into a political football. The benefits have been increased in every election year—1950, 1952, 1954, 1956, and 1958. Even in the nonelection year 1959, 173 bills were offered in Congress to liberalize old-age benefits; so far this year 79 more have been introduced.

This political exploitation has been made possible largely by the semantic device of calling the old-age pensions “insurance,” which has been correctly described as “a stroke of promotional genius.” The term was made plausible by levying nominal “contributory” taxes. As Franklin D. Roosevelt once put it: “We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions and their unemployment benefits. With those taxes in there, no damn politician can ever scrap my social-security program.”

#### ‘THEY PAID FOR IT’

The result today is that the overwhelming majority of commentators in the press, even conservatives, believe that the present recipients of old-age pensions under the OASI scheme have “paid for” the “insurance” they are getting, and consider it an outrage that a man should have to retire from gainful employment at 65 in order to be eligible for his pension. “It is unjust,” according to one recent (and relatively moderate) editorial in a prominent newspaper, “to force them into unwelcome idleness on pain of losing the insurance income bought with deductions from their paychecks and the contributions of their employers.” A less restrained columnist has written: “This imbecilic penalty on grit and gumption bedded in the social-security law screams for redress.”

Now this is a clumsy provision. It does encourage economic waste and premature idleness. But with the present scale of pensions, some restriction like this is unavoidable to prevent the system from going broke or proving ruinous. Ray M. Peterson, associate actuary of the Equitable Life Assurance Society, has pointed out that to remove the limitation on earnings of eligible pensioners would increase outlays immediately by \$2 billion a year and would require additional taxes of 1 percent of covered payrolls.

He calculates that for the vast majority of married couples who entered the system initially or became eligible later by amendments, the value of the benefits they



now get, measured actuarially, is \$10,000 to \$22,000 greater than the value of the combined employee-employer social-security taxes paid. This difference is pure gift. Moreover, so far from its being related to need, the higher the recipient's previous earnings, the greater the subsidy he gets!

### TIME FOR REAPPRAISAL

As one actuary puts it privately: "Sometimes I think it would be a brilliant educational stroke to shame these advocates of the elimination of the work test by allowing them to get the amount of pension their taxes have financed and let them earn all they can between age 65 and 72, because that pension would really be about \$5 a month. Then maybe some of the high-income groups and journalists would quit yelling about eliminating the work test, one of the few features that keeps the Social Security Act from exploding in our face."

The Social Security Act cries for re-examination. It adds nothing to our national output of goods and services; it is merely a device for redistributing income. It gives heavy benefits to the present aged and loads the cost onto the present young. As Peterson declares: "There is probably no other legislative enactment that commits future generations to greater obligations than our Social Security Act." Even the official actuaries of the system place its "unfunded liabilities" at some \$350 billion. A former actuary, W. Rulon Williamson, places them in excess of \$650 billion. The system promotes inflation. Its long-run tendency must be to discourage voluntary saving and self-provision and to increase dependency on government.

The minimum immediate need is to appoint a new advisory council to study the subject in every aspect. ❁

## Inviting Inflation

June 20, 1960

The reduction of the discount rate by the Federal Reserve Banks (of the twelve banks only Atlanta and Boston have yet to act) from 4 percent to 3½ percent, following the action of the Open Market Committee in easing money by supplying additional reserves to the commercial bank system, is a step of dubious wisdom.

It was not taken to combat a serious recession. The day before the action was announced, the First National City Bank of New York, in its June letter, had pointed out that: "Lagging industrial activity has not prevented the nation from enjoying record overall levels of employment and income. Industry is going ahead with plans for enlarged plant and equipment expenditures.

Construction activity is expanding seasonally. Retail trade, which picked up strongly with the arrival of spring, has been sustained at the higher level." True, steel-mill operations have been low, but special conditions like this are not to be cured by cheaper money.

On the same day that the Federal Reserve lowering of discount rates was announced, the Federal Bank of West Germany made the opposite decision. It raised its discount rate from 4 to 5 percent, to combat inflation.

### GOLD PROBLEM REMAINS

This emphasized the international problems raised by our own action. Our gold problem remains serious. Against our gold holdings of \$19.4 billion, short-term liabilities to foreigners reported by American banks come to \$19.6 billion. The deficit in our balance of payments, which reached \$3.7 billion last year, is still running at an annual rate of some \$2.5 billion.

The chief cause of the deficit in our balance of payments is domestic inflation, and consequent diminution of confidence in the dollar. This makes it imperative not only that we halt inflation, but that we follow policies calculated to assure both foreigners and our own citizens that it will stay halted. Yet even apart from the latest Federal Reserve action, we have been mainly doing the reverse. Railroad workers have been officially awarded pattern-setting inflationary wage increases. The Administration is pressing for a bigger foreign-aid program—though foreign aid, both directly and indirectly, tends to increase the deficit in our balance of payments. Higher defense expenditures may be unavoidable; but a Democratic Congress, with an eye on the campaign, is pushing increased "welfare" expenditures—more housing and school subsidies, aid to "distressed areas," old-age medical-care programs.

### THE INTEREST CEILING

One of the most disturbing developments has been the persistent refusal of Congress to remove the 42-year-old legal interest rate ceiling of 4¼ percent on bonds running for five years or more. Contrary to the professed aim of those who insist on keeping the ceiling, it actually increases the interest charges that the Federal government must pay. It prevents the Treasury experts from floating long term bonds when the going rate of interest is more than 4¼ percent, and forces them to glut the market for short-term securities. More serious excessive issue of short-term securities, taken by the banks, tends to increase the supply of money and credit and hence is directly inflationary.

Under policies long followed by the Fed, the main importance of the discount rate has been that of a signal. The lower rate was a deliberate signal that money was going to be made cheaper. The stock market



immediately took the hint. In view of our balance of payments, the wisdom of that signal may be questioned. Banks, moreover, should pay a penalty rate for borrowing from the Federal Reserve—i.e., they should be obliged to pay more for reborrowing than they charge their own best customers. This sound rule has been ignored.

And Federal Reserve discretion has proved sadly wrong in the recent past. The Fed has yielded too easily to inflationary political pressures. It was not wise to have a discount rate of only  $\frac{1}{2}$  of 1 percent from 1942 to 1946; to keep the rate at 2 percent or less for the next nine years; to cut it from  $3\frac{1}{2}$  to as low as  $1\frac{3}{4}$  percent in 1957 and 1958. We cannot indefinitely leave monetary control to bureaucratic discretion or whim. Ultimately we must return to the discipline of the full gold standard. ❁

## Affluent Government

June 27, 1960

In *Newsweek* of Feb. 22, I discussed the Galbraith-Lippmann-Dale thesis that though “private affluence grows . . . there is poverty in the public sector of the economy”; that people really don’t need all the money they bother to earn, that they spend it foolishly, and that therefore still more of it should be seized from them in taxes to be spent wisely by the politicians.

Now the First National City Bank of New York, in its June letter, looks for the statistical evidence on which this thesis rests. It finds it hard to come by. In the past generation (since 1927) the cash intake of the Federal government has multiplied twenty times, though disposable personal income (what people have left after taxes) has multiplied only four times. The Federal government today enjoys a bigger cash income than any other government on earth—a cool \$100 billion a year. Whereas Federal, state and local governments together were spending less than 11 percent of our gross national product in the mid-1920s, and less than 21 percent in 1940, they were spending 31 percent in the mid-1950s.

### TAILFIN VS. WHEAT BIN

The bank presents a table of government revenues and expenditures in the mid-1920s, 1940, and the late 1950s. I append comparisons of some of the leading items for the late 1950s and 1940 alone. The comparisons emphasize the absurdity of the charge that we are “starving” health or hospitals or education or social security. No country approaches our spending on education.

Total public and private expenditures for education in the U.S. reached \$22 billion in 1959, almost triple their level in 1949.

“The preachers of the affluent society doctrine,” says the bank, “are fond of using tailfins on automobiles as the ultimate symbol of unnecessary private extravagance. They are not so apt to mention the wheat bins holding surplus grain for which taxpayers have put up more than \$3 billion. . . . They say nothing about misconceived public-works products and the common abuses of social-welfare programs. . . .”

Despite the unparalleled extravagance of our Federal and local governments, it may be true that we sometimes spend too little for public purposes in some directions. More small parks and plazas in our cities, for example, as in the cities of Europe and Latin America, would not only make our cities pleasanter places to live in but would probably pay for themselves in higher property values. But it is precisely here that our government expenditures are comparatively modest and have increased least. Perhaps the answer is that a park is not a handout to any specific person or group. It is, bluntly, not a good vote-buying device, like farm subsidies or old-age benefits.

### PEOPLE UNFIT TO SPEND

The Galbraith thesis may be reduced to this: That people are individually unfit to spend the money they themselves have earned, but somehow able to choose wisely the officeholders who will seize the money and spend it for them. This doctrine would deprive us, on the ground of our incompetence, of the freedom to spend our own incomes as we see fit. It assumes that people will continue to work to earn the same amounts or more, no matter how much their freedom to keep or spend their earnings is curtailed. It assumes that corporate income taxes of 52 percent, and personal income taxes rising to 91 percent, are not onerous enough, and that socialized spending will not in the least discourage individual earning and production.

The Galbraithians have belatedly discovered that free enterprise produces unparalleled affluence, but they still haven’t found out why.

### GOVERNMENT EXPENDITURES AND GNP

	1940 (in billions)	Late 1950s
Federal	\$ 9.6	\$ 94.8
State and local governments	10.3	48.8
GNP	95.6	463.8

## SELECTED PUBLIC EXPENDITURES

	(in millions)	
Social insurance benefits	\$1,215	\$15,975
Highway expenditures	2,177	8,702
Public welfare and assistance	1,314	3,777
Police	386	1,769
Sanitation	207	1,505
Local parks and recreation	162	685
Hospitals	537	3,849
Education	2,827	16,836✿

## End the Interregnum

July 4, 1960

On Nov. 8 a new President will be elected; but he will not take office until Jan. 20. In this period of ten weeks, President Eisenhower, under the Twentieth Amendment to the Constitution (adopted in 1933) and the Presidential succession act of 1947, will retain the office and legal powers of the Presidency but will lose much of its authority and prestige.

This interregnum, which once lasted four months and still lasts two and a half, has always been potentially dangerous. On several occasions it has done incalculable harm. It was in the four months between the election and inauguration of Lincoln that seven states seceded from the Union and set up the Confederacy. In the interregnum after Franklin D. Roosevelt defeated Herbert Hoover in 1932 business confidence deteriorated rapidly; insolvencies, bank closings, and unemployment mounted. Roosevelt still lacked power to act; Hoover then lacked the public support to lead.

The problem was posed also in 1916. "Again and again," wrote President Wilson to Secretary Lansing in that year, "the question has arisen in my mind, what would it be my duty to do were Mr. Hughes to be elected? Four months would elapse before he could take charge of the affairs of the government, and during those four months I would be without such moral backing from the nation as would be necessary to steady and control our relations with other governments. . . . Such a situation would be fraught with the gravest dangers."

## WILSON'S SOLUTION

It would be his duty, he concluded, "to relieve the country of the perils of such a situation at once," and if he could gain the consent of the persons involved, to "join the Vice President in resigning and thus open to Mr. Hughes the immediate succession to the Presidency. . . . The whole country has long perceived, without knowing how to remedy, the extreme disadvantage of having to live for four months after an election under a party whose guidance has been rejected at the polls."

Though the interregnum period has been shortened by the Twentieth Amendment, it has not been eliminated. The succession act of 1947 prevents the solution proposed by Wilson in 1916. Yet the dangers of that period have been incalculably increased both by the potentialities of nuclear-missile blackmail and warfare and by the propensity of the Communists—Russian, Chinese, Cuban, or what not—to exploit any interval of weakness, uncertainty, or indecision.

There is still time, in the remaining days of the present session, for Congress to eliminate these needless risks and dangers. No further tampering with the Constitution is necessary. All that is needed is the appropriate changes in the Presidential succession law. Congress could simply add a provision permitting an outgoing President to resign in favor of the President-elect.

## NONPARTISAN REFORM

It need hardly be added that such a revised law should impose no economic penalties on resignation. It should provide that the salary of any President who resigned for this purpose would be continued until Jan. 20, just as if he had remained in office. The new law should also, preferably, give the Vice President and each outgoing congressman or senator the same right of immediate resignation in favor of his elected successor, under similar salary provisions.

There would be nothing obligatory about such resignations. But once legal provision were made for them, and the precedent set, both outgoing congressmen and outgoing Presidents would probably be eager to take advantage of it. Nobody likes the label or the status of a lame duck.

I made a similar proposal in *Newsweek* of Nov. 17 and Dec. 1, 1952, following the election of Mr. Eisenhower. But proposals of this sort are too often judged by the way in which they will immediately affect specific persons. These few weeks before the nominations, and when nobody is sure whether our next President will be a Republican or a Democrat, would seem to be an ideal time for Congress to make this

reform. Patriotic men of both parties could agree to it on a completely impersonal and nonpartisan basis. ❁

## Why Our Debt Grows

July 11, 1960

We ended the fiscal year 1960 with a national debt of \$286 billion. In addition to this direct and avowed debt, our government has contingent obligations of some \$316 billion, not including unfunded social-security liabilities of \$350 billion or perhaps \$650 billion, depending on the assumptions on which they are calculated. Our national debt, including contingent liabilities, is not only the highest in the world in absolute amount but the highest in relation to annual government revenues.

What would we think of the prudence of a man with a yearly income of \$7,900 who owed \$29,000 and had endorsed, in addition, IOU's of relatives totaling \$31,600 or even \$76,000 more? Multiply these figures by 10 million and you get the position of our government.

It has long been fashionable to say that the maxims of fiscal conduct that apply to an individual do not apply to a nation. One facile argument, brought forward in the early days of the New Deal, is that the size of the national debt does not matter because "we owe it to ourselves." Though this argument was put forward as a new discovery, it was really very ancient. In 1740, a generation even before the publication of Adam Smith's *Wealth of Nations*, Smith's countryman, the philosopher David Hume, in a remarkable essay, "Of Public Credit," dealt with it specifically:

"We have indeed been told that the public is no weaker upon account of its debts, since they are mostly due among ourselves and bring as much property to one as they take from another. It is like transferring money from the right hand to the left; which leaves the person neither richer nor poorer than before. Such loose reasoning and specious comparisons will always pass where we judge not upon principles."

### DESTRUCTIVE TAXES

Hume went on to point out that the people who pay the taxes are not necessarily the same as those who receive the interest, and certainly never in the same proportion. Taxes always fall upon the most productive people in the community. "If all our present taxes be mortgaged, must we not invent new ones? And may not this matter be carried to a length that is ruinous and destructive?"

This was not the only "modern" fallacy that Hume answered. It was only last August that Britain's official

Radcliffe report announced that a big public debt "gives strength" to a nation. Yet more than two centuries ago Hume was writing: "What, then, shall we say to the new paradox, that public incumbrances are of themselves advantageous, independent of the necessity of contracting them; and that any state, even though it were not pressed by a foreign enemy, could not possibly have embraced a wiser expedient for promoting commerce and riches, than to create funds and debts and taxes without limitation? Reasonings such as these might naturally have passed for trials of wit among rhetoricians, like the panegyrics on folly and a fever, on Busiris and Nero, had we not seen such absurd maxims patronized by great ministers, and by a whole party among us."

### A CAUSE OF INFLATION

Hume proceeded to point out not only that interest payments on the debt must raise taxes, but that "public securities are with us become a kind of money . . . a kind of paper credit," with "all the disadvantages attending that species of money." In brief, he saw that debt led to inflation.

And Hume also recognized clearly that the persistent political pressures were all on the side of incurring debt rather than repaying it. "It is very tempting to a minister to employ such an expedient as enables him to make a great figure during his administration, without overburdening the people with taxes, or exciting any immediate clamors against himself. The practice, therefore, of contracting debt, will almost infallibly be abused in every government. It would scarcely be more imprudent to give a prodigal son a credit in every banker's shop in London, than to empower a statesman to draw bills, in this manner, upon posterity."

Hume was not too hopeful regarding the future. "I must confess that there is a strange supineness, from long custom, crept into all ranks of men, with regard to public debts." ❁

## The New Collectivism

July 18, 1960

Though the old doctrinaire socialism "public ownership and operation of the means of production" is in disrepute in the Western world, a new brand of socialism is now on sale. It does not insist on the socialization of production but on the socialization of consumption.

The New Socialists—or perhaps they should be called the New Collectivists—are at last willing to admit that capitalism, private enterprise, is incomparably more



productive than socialism. But they don't like what it produces. For under capitalism, it seems, people spend the money they earn in foolish and trivial ways and show dreadful taste. The government, therefore, the bureaucrats, the "public servants," should step in and seize this money from them by imposing far more drastic taxes than the piddling sums people pay today, and spend the money not on the things that people individually want, but on what they would want if they were competent to know their own interest.

The chief spokesman for this New Collectivism is J. Kenneth Galbraith, but he has been rapidly acquiring disciples, of whom Charles F. Darlington, author of a piece in *The New York Times Magazine* of Sunday, July 3, seems to be typical. His thesis is stated in his second paragraph: "Nations, like individuals, can make vices of their virtues. Private enterprise is a virtue as a successful method of organizing society for production, but it takes on the color of a vice when, as today in the United States, it is widely regarded as the ideal of society. It is a means to a good society, but we are making it society's goal."

### MEANS AND ENDS

The title of Darlington's piece is "Not the Goal, Only the Means." This is a false antithesis. Many things may be both means and ends. An outstanding example is liberty. Liberty is an indispensable means of accomplishing all our other purposes; but it is also an end in itself. Lord Acton went so far as to say that liberty "is itself the highest political end."

Now capitalism, or private enterprise, is simply another name for liberty in the economic sphere. It leaves the Individual free to produce what he wants and free to consume what he wants. It allows him to keep the fruits of his labor. It protects him in that right by the institution of private property. Private enterprise is not merely a means; it is not simply a remarkable gadget for production; it is also an end in itself. It is the system of economic liberty. Once economic liberty is abridged or destroyed all other liberty is abridged or destroyed with it. "Power over a man's subsistence," said Alexander Hamilton, "is power over his will." The freedom to spend is only a little less important than the freedom to earn.

### FREEDOM REDEFINED

Darlington wishes to deprive the individual of this freedom. To make his argument seem plausible he has to redefine freedom, individualism, private enterprise, and government. "Freedom, above all for a great people, is found in doing what is morally right." Who is to decide what is morally right? Darlington replies that "we" (presumably he and Galbraith) "know what is right. . . . We

know that it is right for the rich to succor the poor . . . at home and abroad." And this can be interpreted to mean that the industrious and efficient must be drastically taxed to compel them to support the shiftless and inefficient at home and socialist experiments abroad.

The "mainspring" of private enterprise is "self-interest, which is highly useful in getting things done, but self-interest idealized approaches selfishness." Here is another basic confusion. Private enterprise does leave people free to pursue their own purposes. But are these necessarily selfish purposes? Is a man who works to support a large family and send his children to college acting selfishly? Are people selfish just because they are free? And if we compel them, through the government apparatus of coercion, to support the purposes of the politicians in power, does this make them unselfish?

The essence of collectivism is to belittle the purposes of the individual in favor of those of some mystic collectivity. The "national purpose" is no different from the purposes of the individuals who compose the nation. ❁

## Evil of Import Quotas

July 25, 1960

So far as immediate policy is concerned, Congress was justified in granting and the President in using discretionary power to slash the Cuban sugar quota. The President, in fact, should have asked and Congress should have granted even wider discretionary powers many months ago, when Castro first started seizing American property and vilifying us.

As it is, our timidity, our declared fear of doing anything to injure "the Cuban people," our failure even to stop subsidizing the Cuban economy, led Castro to conclude that he could go further and further with impunity. Our action came only after 2,380,000 of Cuba's 3,120,000 quota of short tons for 1960 had already been certified for entry. The President had to cut 95 percent, or all but 40,000 tons of the 740,000 ton remainder. By that time Castro had burnt too many bridges behind him. Face-saving forced him to go further.

It is gratifying that when the President did act he acted firmly, and refused to allow himself to be bluffed by the Khrushchev threats. It is the duty of every nation to protect the lives, persons, and property of its citizens abroad. We should take whatever economic or diplomatic countermeasures our own interests require.

### EXORBITANT COST

It is disheartening, however, to find that the only way the Administration can think of to protect our rights



and to “counter Communism” in Latin America is to plan a still bigger “economic assistance” program there. This is getting to be hard to distinguish from an uneasy payment of tribute. The billions we have already given away globally have failed either to halt Communism or to win us reliable allies.

As for our long-run policy concerning sugar, what is required is not a readjustment of quotas but abolition of the quota system. That system goes back to the depression-inspired Jones-Costigan Act of 1934. The purpose of this legislation has been to “stabilize” the price of sugar and to protect our domestic producers. It has done so at an exorbitant cost.

An import-quota system must be discriminatory as between exporting nations. It breeds resentment in all but the most favored. Ironically, our sugar-quota system was set up especially to favor Cuba which, in addition to being allotted 96 percent of all foreign imports (apart from the special case of the Philippines), was granted a tariff preference and got from us a premium of 2 cents a pound above the world market. Now that we have cut that quota, Castro can plausibly claim that we are discriminating against Cuba.

We pay a heavy price to subsidize a domestic sugar production equal to only about a fourth of our total sugar consumption. In order to make our import-quota system work we also enforce a quota for every individual domestic producer.

#### TARIFF LESS HARMFUL

I have no wish to advocate tariffs. But if we want to continue to protect our domestic sugar producers, we can do it just as effectively through a higher tariff as through a quota system, without discrimination between foreign countries, with infinitely less red tape, and without authoritarian production controls at home. A uniform tariff would allow foreign countries to sell to us in proportion to their efficiency and costs. It would also allow our domestic producers to compete with each other on the basis of their individual efficiency and costs. Though our consumers would have to pay the duty in the price, most of it would go to the government in revenues, and (unless its total expenditures were increased) come off their taxes somewhere else.

A tariff is at least compatible with the continuance of an otherwise free economy; a quota system is not. Our regimentation of the sugar market has set an evil precedent. Practically everything that is wrong with our import-quota system in sugar is equally wrong with our recent import-quota system in oil. Here again, everything that a quota system accomplishes in holding up the price or holding down supply (assuming either aim to be desirable) could be accomplished much more

flexibly and efficiently by a tariff, which would at least permit volume and cost competition within the domestic market. ❁

## The Total Welfare State

August 1, 1960

The Democratic platform reads, at times, more like a parody than a serious document. It states mere wishes or problems as if it were stating solutions. It favors “an enduring peace . . . ending nuclear tests under workable safeguards . . . preventing surprise attack.” If you ask how it proposes to achieve these goals, why, it will set up “a national peace agency”!

When it comes to economic policy the platform drops all pretense to consistency or responsibility. It promises to “unshackle” American enterprise apparently by imposing new controls in every direction. We are told that “our economy can and *must* grow at an average rate of 5 percent annually.” Why stop at 5 percent? Why not 6 percent? Or if we are only talking about “goals” why not 50 percent? The platform framers should recall Shakespeare: “If to do were easy as to know what were good to do, chapels had been churches, and poor men’s cottages princes’ palaces.”

The Democrats “pledge” themselves “to policies that will achieve this goal without inflation.” However, “as the first step in speeding economic growth,” they demand an inflationary cheap-money policy. They would try to offset their own monetary inflation, they strongly imply, by the reimposition of price controls.

#### ‘THE RIGHT TO A JOB’

The platform presents an “economic bill of rights.” This includes the “right” not only to a job but to a “remunerative” job. Nothing whatever is said about the diligence or qualifications of the worker, or about who is to be forced to supply the job, if it doesn’t exist. A new WPA?

“Full employment,” which has become a synonym for a policy of inflation, is made “a paramount objective.” “The right to a job,” we are told, “requires the restoration of full support for collective bargaining.” But it does *not* require state right-to-work laws. These are to be forbidden.

“Every farmer” (Why just the farmer? Why not everybody in every line?) is guaranteed “the right . . . to raise and sell his products at a return which will give him and his family a decent living.” Nothing is said about the need for his particular crop. Nor are we told who is to be forced to buy his crop at a profit above his

cost, however high that happens to be. There is to be “positive action to raise farm *income* to full parity levels.” As more surpluses pile up in our warehouses they are to be treated “not as a liability but as a national asset.”

Everyone has the “right” not only to a home but to a “decent” home, even to “recreation”; and, of course, “the right to adequate medical care.” For the cities, a new Democratic Administration will help “clear their slums, dispose of their sewage, educate their children, transport suburban commuters . . . and combat juvenile delinquency.” No family or city will need to do anything for itself. As the French economist Bastiat put it more than a century ago: “The state is the great fiction by which everybody tries to live at the expense of everybody.”

### ALL SUBSIDIZE ALL

After the Democratic platform pledges new and bigger expenditures in every direction, it declares with bland effrontery that “these needs can be met with a balanced budget, with no increase in present tax rates, and with some surplus for the gradual reduction of our national debt.” However, “*if* . . . the unfolding demands of the new decade . . . cannot be fulfilled without higher taxes,” the Democrats promise to impose them.

What we have, in sum, is a pledge to impose a total welfare state.

The Democratic Presidential candidate, after ordering and accepting all these sweeping promises of security, with no mention of any return by the individual in effort or obligation, then declared, in baffling contradiction, that he was appealing to the American people’s “pride, not their pocketbook,” and promising “more sacrifice, instead of more security.” More sacrifice just for taxpayers?

But he has yet to reveal the details of his personal platform. So far, its chief plank might be summed up by paraphrasing the Lord Chancellor in “Iolanthe”:

*Youth is the sole embodiment  
Of everything that’s excellent.  
It alone discerns the truth,  
And I, my friends, embody Youth.* ❁

## A Circus or a Session?

August 8, 1960

The country can look forward to the forthcoming session of Congress only with profound misgiving. Its temper was foreshadowed by the action of Congress on July 1 in passing over the President’s veto a Federal pay increase of \$764 million a year, correctly described by Mr. Eisenhower as “indefensible by any light.” A few

routine appropriation bills may need to be passed. But the session was planned mainly to push big-spending or statist measures as part of the Democratic campaign.

There are five of these measures: A school-construction bill, a housing bill, the \$1.25 minimum wage, a farm bill, and medical care for the aged. Not one of these is urgent. All would do harm. The school-construction bill would pour Federal funds and spread Federal power into an area which has been and ought to be the sole responsibility of the localities. Socialized housing, invading the field of private enterprise, leads directly toward the total welfare state.

As for the minimum wage, if money wages could be raised by government fiat, without loss of real purchasing power and without causing unemployment, there would be no point in stopping at \$1.25 an hour. The higher minimum may raise some persons, hitherto receiving less, to that figure. But it is certain to throw others out of employment altogether unless the purchasing power of the dollar is further diluted.

### INVERTED PYRAMID

The proposed farm bill will merely make the farm fiasco worse. It will increase the unmanageable farm surpluses that already cost us more than \$1,000 a minute just to store. The medical care proposals are being hastily piled on top of a tremendous inverted pyramid of claims with a contemptuous disregard for ultimate costs or a cynical pretense that a nominal increase in tax contributions will “pay for” them. What the Social Security Act desperately needs, before still more unmeasured obligations are blindly assumed, is reexamination by a new advisory council.

The new session will be supercharged with partisan emotion, and create opportunities for infinite political mischief. The Democratic strategy will be to pass measures offering huge handouts to pressure groups. If these are vetoed by the President, the Republicans will be blamed for their defeat. If the measures become law, the Democrats hope to grab the credit. And in the Republican me-too mood, the prospects of defeating the measures are not bright. The country seems likely to take a further plunge into welfare socialism, big spending, and inflation.

And yet, if either party cared to seize it, the new session also provides an opportunity for responsible statesmanship and constructive achievement. I will mention only two items.

### TO AVERT PARALYSIS

The President ought to renew his plea for a removal of the 42-year-old legal interest-rate ceiling of 4 percent on bonds running for five years or more. The effect of this ceiling is to compel excessive issues of short term

securities. These are taken by the banks, and force an inflationary increase in the supply of money and credit. Repeal of the ceiling would go far to restore confidence in the dollar at home and abroad.

The other item is an amendment to our Presidential succession law to permit an outgoing President to resign in favor of the President-elect on any date that both might agree to after Election Day and before formal Inauguration Day on Jan. 20. The same right to offer an earlier transfer of office, without salary loss for incumbents, should be extended to outgoing House and Senate members. The mere existence of such a provision might forestall an effort on the part of the Communists—Russian, Chinese, Cuban, Congolese, or what not—to exploit what would otherwise be a two-and-a-half-months' interval of uncertainty and indecision. In May, let us recall, Khrushchev declared he would not attempt to change the existing situation in Germany or West Berlin until after our elections in November but he did not promise to wait until after Jan. 20. The country cannot afford a period of paralysis in domestic or foreign policy simply because legal provisions for the transfer of power are rigid and inflexible. ❁

## To End Farm Surpluses

August 15, 1960

The details of Nixon's farm program have not yet been revealed, but his announcement of July 31 did not sound promising. He repudiated Secretary Benson, who has tried to move toward sense and sanity. "We must develop a massive program," said Nixon, "which is not concerned with budgetary costs year by year." As the government had put the farmer in his present fix by its wartime policies, "obviously the government must pay the cost of getting him out."

This "new" farm program may turn out to be a serious political blunder, of which Kennedy has already taken advantage. Nixon cannot repudiate the record of the Eisenhower Administration in a major field. And an airy dismissal of "budgetary costs" would undermine his own main case against this year's Democratic platform.

In any event the foreshadowed program sounds like a major economic error. What does Nixon mean by a "massive" program? Isn't a cost to the Federal government of \$5.5 billion a year, mainly to pile up unsalable crop surpluses, massive enough to suit any taxpayer?

Would more massive payments do anything but pile up more massive surpluses?

The best farm program would be one to end "farm programs." The major farm problem today is that created by the government itself.

### SUPPORTS CAUSE SURPLUS

The constantly repeated contention that present crop surpluses are the result of a "technological revolution" on the farms is untrue. These chronic surpluses have occurred only in the crops under which the government has stuck price supports. The crop surpluses were built up by setting government price floors higher than the prices farmers could obtain in a free market. This caused the farmers to plant more than otherwise or to pour in more fertilizer to get more per acre. The higher prices also cut down the market demand. If support prices were stopped, farmers would raise less and consumers would buy more. Surpluses would cease to pile up.

What about the surpluses that already exist? That problem too could be solved in a single growing season. The government need merely sell back to the farmers themselves the surpluses it acquired from them. Before the new planting season for each crop of which the government holds a surplus, it could offer each grower his prorated share (figured on his previous acreage allotment) at a price set below the expected world market price and below the farmers' own average cost of production. The government might issue to each farmer transferable certificates entitling the bearer to buy so many pounds of cotton or bushels of wheat at this bargain price. The farmer could then either turn in the certificates with the required amount of cash if he wanted to buy the crop to hold for later resale, or he could sell the certificates themselves in the open market. They would naturally sell at a price equal to the amount by which the free market price exceeded the low purchase price set on government holdings.

### OPERATION DISPOSAL

Few farmers, except those with unusually low costs, would be foolish enough to plant more of that crop that year. They would know in advance that it would not pay them. From their sale of certificates they would get on the average a net income equal to what they would have received if they had planted a crop. They would have the choice of allowing their acreage previously planted to that crop to remain idle, or planting it to some other crop in which there were no accumulated surpluses.

As a result, the surpluses would be disposed of. The farmers would be free of regimentation and all acreage



control. The government would, it is true, take a book-keeping loss on stored crops held at its artificial cost prices. But instead of paying out more billions in cash, it would be *receiving* billions in cash from world consumers from the sale of surpluses.

After that Operation Disposal, the government should get out of the whole price-support fiasco and stay out. The price-support scheme has been a mainstay of the welfare-state sleight of hand which, as Wilhelm Röpke puts it, “robs nearly everybody and pays nearly everybody, so that no one knows in the end whether he has gained or lost in the game.” ❁

## The Irresponsibles

August 22, 1960

In the present session of Congress, deliberately planned by the Democratic leaders as a campaign forum, President Eisenhower had a unique opportunity to call upon the members of both parties to rise to the responsibilities that the critical state of affairs abroad and at home lays upon them. The actual message he sent fell short of this, in both its omissions and its recommendations.

The most serious domestic issue today is the preservation of the integrity of the dollar. This requires an end to reckless Federal spending. It requires the tapering off or termination of some of our major spending programs. It requires not merely the passive consent of Congress to monetary discipline on the part of the Federal Reserve authorities, but positive Congressional insistence on such discipline. It requires removal of the interest-rate limitation on long-term Treasury bonds.

Yet the President's message gave only a single perfunctory sentence to this last need, and nobody seriously expects the present electioneering session to pay the slightest attention to it. On the very day that the President was promising to “resist inflationary pressures by whatever means are available to me,” the Federal Reserve Board announced a reduction of member-bank reserve requirements to provide a potential expansion of lending power of some \$3.6 billion. This action to increase the money supply was directly inflationary.

### MONEY NOT ‘TIGHT’

The only criticism the Democrats make of the Federal Reserve is that it has been “strangling” the economy with a “tight-money” policy. Yet as the First National City Bank of New York pointed out in its August letter, in an illuminating table covering 60 countries, the

current rate for prime commercial loans in this country is among the lowest in the world.

Though the President spoke against “reckless spending schemes,” he came out, on every specific issue, on the side of more spending. This applied to foreign aid, “food for the hungry,” medical aid for the aged, and assistance to depressed areas.

Suppose we test one or two of these programs by the principles of fiscal responsibility or free enterprise. The long-run effect of the ever-expanding program for foreign economic aid must be to slow up national and world economic growth, not to accelerate it. An “underdeveloped” country grows more soundly and rapidly when it seeks to attract foreign and domestic private capital by assuring protection of person and property, permitting withdrawal of earnings at all times, and giving assurances against vexatious restrictions or harassment, burdensome or uncertain taxation, expropriation, and making or keeping its currency inconvertible.

### SUBSIDIZED SOCIALISM

But when a foreign country can get loans or gifts from our government without giving such assurances, it will not bother to give them. It will launch instead upon grandiose socialistic projects more calculated to sound good in speeches or to appeal to national vanity than to repay costs. Our “economic” foreign-aid program subsidizes and expands world socialism, and tends to deflect capital from constructive to wasteful use.

In special cases, when hunger follows some calamity outside the control of the country affected, aid from outside is more than justified. But as a regular established giveaway *program* it is shortsighted. It becomes an excuse to make uneconomic crop surpluses permanent. A country like the United States, which raises only an eighth of the world's food supply, cannot hope to feed the world. When we dump food on another nation at less than world prices we merely discourage growers in that nation, or in still other nations, from raising the food they are physically and economically capable of raising. Such a program will not in the long run encourage either self-help or a net increase in the world's food supply.

Apart from a strong military posture, the most important contribution the United States can make to the world's economic strength and stability is to maintain confidence in the dollar. Yet, broadly speaking, the Republicans are giving only perfunctory attention to that goal, while the Democrats are ignoring it altogether. ❁



## How to Beat Inflation

August 29, 1960

Between them, the present session of Congress and the Federal Reserve seem to be working toward cheaper money and more inflation.

From time to time I get letters from readers asking how they can protect themselves from the eroding effects of inflation on their savings. It is possible to answer this question in a way that is helpful to a particular individual; it is not possible to answer it in a way helpful to everyone. What is still not widely understood is that inflation can benefit one man only at the expense of another. The price of what you have to sell can go up more or faster than the average price of what you have to buy only if the price of what other people have to sell to you goes up less or slower than the price of what they have to buy from you. Roughly speaking, one-half of the population can gain from inflation only at the expense of the other half. The political appeal of inflation comes from fostering the illusion in the great majority of voters that they will somehow get the better of the swindle, and profit at the expense of a few unidentified victims.

The pressure groups for inflation do vaguely or explicitly understand this. An inflation is initiated or continued in the belief that it will benefit debtors at the expense of creditors, or exporters at the expense of importers, or workers at the expense of employers, or farmers at the expense of city dwellers, or the old at the expense of the young, or this generation at the expense of the next. But what is certain is that everybody cannot get rich at the expense of everybody else. There is no magic in paper money.

### HE WHO ACTS FIRST

It is true that an alert individual can do certain things to protect himself from the eroding effects of inflation on the value of his dollars but only if he acts both sooner and more wisely than the majority.

Even this used to be easier than it is today. In the German hyperinflation which culminated in 1923, a German could always buy American dollars, at the current rate in marks, as soon as his monthly, weekly, or daily income above current needs became available to him. But Americans today have no completely safe major foreign currency to turn to. They are prohibited by law from buying and holding gold at home. If they buy gold abroad, they face the risk that our government (following the domestic precedent of 1933) may force them to turn in their holdings at an arbitrary value in paper dollars.

They are left, then, in practice, with the choice of buying real estate, common stocks, cars, TV sets, paintings, Oriental rugs, jewelry—any equity or luxury that is not dollars or a fixed obligation payable in dollars. They are forced, in short, into extravagance and speculation.

### MUTUAL FUNDS

An inexperienced speculator may, of course, turn to investment trusts or mutual funds which diversify his investment for him and protect him to some extent against his own lack of expert knowledge. But always, the people who buy first, or at lower prices, can profit or protect themselves only at the expense of those who buy later or at the top.

It is impossible, in short, for everybody to protect himself against inflation. The early minority can do so only at the expense of the late-comers. And a scramble to get out of money and into things only intensifies the inflation, only increases and accelerates the rise of prices or the fall of the dollar.

This last result must follow whether individuals try to protect themselves against inflation by individual action or through such group devices as escalator wage clauses or escalator bond clauses. Such schemes accelerate inflation. Neither prices nor wages go up uniformly. Suppose some wages and prices have gone up 100 percent, and other wages and prices not at all. The average increase may be 50 percent. If cost-of-living escalator clauses are prevalent, and the wages or prices that have not gone up are raised 50 percent, the *average* wage or price level may be raised by that act itself to 75 percent. And so on.

There is only one solution only one sure hedge against inflation that can protect everybody: Don't have the inflation. If you have it, halt it as soon as possible. ⚙

## Is 'Deflation' Likely?

September 5, 1960

"Not inflation, but deflation is the new official worry."

Such is the explanation now offered in some Washington reports for the action of the Federal Reserve authorities in lowering reserve requirements to add \$3.6 billion to the money-and-credit-creating powers of the nation's banks, in twice reducing the discount rate within three months, and in forcing down the prime lending rate. It is also put forward as the explanation of the increased spending programs in Congress, and pressure for medical care for the aged, higher farm price supports, and a higher minimum wage.

The slump in steel output, in construction, in appliance sales, the squeeze on profit margins, the relatively high levels of inventories and unemployment, are among evidences cited for the “deflation” that is feared.

There is nothing new in this fear. If one looks back over the record of the last twenty years, one finds a steady progress of inflation, with the total supply of bank deposits and currency up 270 percent between 1939 and 1959, and consequently with wholesale prices up 136 percent, and consumer prices up 113 percent, for the same period (see this column May 2).

Yet all during this twenty-year period it may be doubted whether a single week went by without at least somebody in Congress or the press expressing the fear that “deflation” might be just around the corner unless the economy were given a fresh inflationary shot in the arm.

### MISUSE OF TERMS

These fears, to the extent that they are real, rest upon a misuse of terms and a confusion of thought. There has never been the slightest danger of “deflation” since 1933 in the true sense of a major contraction in the supply of money and bank deposits. Inflation means an increase in the supply of money and bank credit. The rise of commodity prices and living costs which almost inevitably follows is not the inflation but the consequence of the inflation. But by a still further extension of the two terms, any prosperity is called “inflation” and any recession or unemployment is identified with “deflation.”

This can lead to endless confusion. For, as illustrated in Germany and elsewhere since World War I, a sharp business recession and heavy unemployment can occur in the very midst even of a hyper-inflation.

Inflation works its apparent magic only in the short run, and only as long as final prices are rising faster than wage rates and other costs, so that employment and activity are stimulated by attractive profit margins or prospective profit margins. But if wage rates, taxes, or other costs rise as fast as or faster than selling prices, and start squeezing profit margins or inflicting losses on marginal firms, activity will fall and unemployment rise.

### MONETARY MANAGERS

A new hike in minimum wage rates, and an extension of coverage, with 4 million already unemployed, would not be very intelligent. Its tendency would be to increase unemployment among the very groups it is ostensibly designed to help unless, of course, the purchasing power of the higher money wage rates were reduced by another dose of inflation.

What Congress and the Federal Reserve are in effect saying is that no recession is ever to be corrected

by individual wage or price adjustments, but only by further doses of inflation to boost the whole price level. In fact, instead of there being any correction of uneconomically high wage rates in a recession, wage rates are to be hiked still higher.

It remains to be seen whether present inflationary policies will have their intended economic and political effects. They will surely do nothing to restore our export markets, to correct our adverse balance of payments, or to increase foreign confidence in the dollar. They are more likely to induce a further drain on gold stocks already slightly exceeded by our short-term liabilities to foreigners.

The recent actions by the Federal Reserve authorities not only seem unwise, they raise once more the whole question of whether monetary managers can be trusted, in the long run, to use wide discretionary powers wisely or whether restoration of a full gold standard, governed by strict and quasi-automatic rules, would not be preferable after all. ❁

## Sugar, Fares, Picketing

September 12, 1960

Import quotas: Our foreign policy becomes more and more incomprehensible. Castro seizes more than \$800 million of American property in Cuba, arrests our citizens, engages daily in a calculated hate America campaign, and we dare not break off relations with him. Then we break off relations with Trujillo, who had not seized American property, arrested our citizens, whipped-up a hate American campaign, or invited the Russians in.

We explain that Trujillo is a “dictator” as if Castro were not a far more dangerous one, so far as our interests are concerned, and as if we were not recognizing scores of dictators all over the world, including Khrushchev himself. We continue to recognize Khrushchev though he shoots down our planes and murders our aviators above neutral waters.

No one in the Administration has seemed to consider what the long-run consequences are going to be of our strange sugar policy. Who is to be allowed to send sugar to us, and exactly how much, and whether those who sell to us are to be paid a bounty over the world price, is to be decided by Congressional fiat or the day-to-day whim of the Administration. The U.S. is still committed to pay the Castro government a subsidy of about \$96 million a year above the world price for the 2.4 million tons of sugar remaining in the Cuban quota.

The resentment and economic disruption we are going to cause by this discrimination can easily be foreseen. The first step toward economic sanity and freedom would be to abolish entirely the whole sugar import-quota system and to substitute a uniform tariff. This would also allow us to abolish domestic quotas.

### **Socialist 'Profit'**

"City Transit Nets \$5 Million Profit" ran the headline. What a triumph for municipal ownership and operation! At last an answer to the critics of local socialism. For though the New York City subways had tripled their fares since the city took them over, they could not seem to show anything but an operating deficit. The 1958-59 operations, for example, had shown a deficit of \$10,184,316.

How has the new miracle happened? Well, the Transit Authority concedes that it did receive a little help. There were subsidies from the city totaling \$18,604,499. Without them the city's transit lines would have shown a deficit in the fiscal year ended June 30 last of \$13,391,570. But such a detail ought not to be allowed to obscure the great fact that the Transit Authority's books did show a "profit" of \$5,212,928. Could private enterprise, paying heavy taxes instead of getting them, have done as well?

### **Why Labor Chaos**

If you want to know why we have labor violence, if you want to know why an employer has no way of settling a strike except by giving in to the demands of the union, if you want to know why the government itself is impotent to halt what it calls "cost-push" inflation, you have merely to read the decision of the National Labor Relations Board holding the Kohler Co. guilty of prolonging by unfair labor practices the six-year-old strike by the United Auto Workers Union.

The board admits that the union engaged in illegal "belly-to-back" mass picketing and violence after the walkout began on April 5, 1954. But the board apparently regarded this violence as trivial compared with the unfair labor practice engaged in by Kohler. And what was this unfair labor practice? Why, the company granted a wage increase of 3 cents an hour to nonstrikers "without bargaining with the union."

So the board ordered Kohler to rehire all the strikers (except 77) who had not been permanently replaced prior to June 1, 1954, the day of the wicked wage increase, provided they applied for reinstatement. The union estimates that this might mean replacing 1,700 to 2,000 of the total 2,500 that the company employs. And the board specifically ordered that this should be done even if it required discharge of the replacements,

some of whom have now acquired six years seniority with Kohler.

Whatever "collective bargaining" is now interpreted to mean, it obviously does not mean *free* bargaining. The employer, or the non-union worker, has no bargaining freedom that any one is bound to respect. ❁

## **Legal Strike Incentives**

September 19, 1960

It can be hazardous to write in a weekly magazine about a strike that could be settled at any hour of any day. But it seems reasonably safe to predict that the Pennsylvania Railroad strike settlement, when it comes, will be in favor of the strikers and distinctly not in favor of either the railroad or the traveling public. This will happen for the same reason that the 1959 steel strike and the recent Long Island Rail Road strike were settled in favor of the strikers and not in favor of the consumers or commuters. That reason is the existence of a set of Federal labor laws that make it all but impossible to settle a strike except by giving in to the demands of the union.

All during the long steel strike the Administration kept repeating that it was not "interfering" and would not "interfere." Its protestations were made sincerely. They were accepted at face value by most of the press. Yet both before and during that strike the Federal government was in fact interfering every day through laws laying down one-sided rules of the game that it had enacted over the past 30 years notably the Norris-LaGuardia and Wagner-Taft-Hartley acts.

### **ONE-SIDED LAWS**

These set up a situation in which the employers were forced to negotiate with the strike leaders, no matter how unreasonable the latter's demands might be, for the simple reason that the law in effect compelled this and forbade the employers to negotiate with anybody else. And the strikers could throw mass picket lines around the steel mills with impunity, and physically prevent anybody else from applying for the jobs that they had voluntarily vacated, while the Norris-LaGuardia Act effectively denied the employers injunctive relief.

True, the railroad labor situation is somewhat different, owing to the fact that Congress (never troubled about consistency) has written and retained a different law for railroad labor than for other labor. Under the Railway Labor Act of 1926, elaborate machinery is set up by which no strike can take place until the President



has appointed an emergency board to make strike settlement recommendations.

But the unions have found that they can successfully reject the Presidential board recommendations when these are not wholly to their liking. This happened in 1941 under Mr. Roosevelt and in 1946 under Mr. Truman. It is happening under Mr. Eisenhower in the present strike. Mr. Roosevelt simply reconvened his board and ordered it to try again; so the board dutifully brought in another decision still more in the unions' favor. Mr. Truman personally granted the strikers more than his board had granted them. The Quill union, which has rejected the recommendations of President Eisenhower's emergency board, is obviously hoping that something like this will happen now.

### FORCED ARBITRATION?

The Pennsylvania Railroad has, unwisely, suggested that the President be given authority to compel binding arbitration in a dispute of this kind. Such a step would lead inevitably to general government wage fixing and price fixing.

The real need is to move in precisely the opposite direction. We need a sober reappraisal of the Federal labor laws of the last 35 years, and of the assumptions on which they are based. We should stop making a fetish of the phrase "collective bargaining." As interpreted by the unions, and by government boards, it assumes that bargaining *must* be collective in other words, that it must *not* be individual. What we need to restore, both to the employer and the individual worker, is *freedom* of bargaining. This means that an employer should no longer be *compelled* to negotiate with a specified union, though he may always voluntarily agree to do so. It means that in a strike he should have freedom to hire any replacements willing to accept employment. The role of government should be to prevent violence, coercion, mass picketing, or any other form of intimidation.

The one-sidedness of our labor laws is ironically emphasized by the suit filed by the nationwide Brotherhood of Railroad Trainmen charging the nation's railroads with "conspiracy" for daring even to set up a common strike insurance fund, and demanding that such protection be outlawed. ☸

## Vote for Me and \$7,000

September 26, 1960

All through the twenty years of the Roosevelt and Truman Administrations, from 1933 to 1952,

Democratic orators both implied and stated that to vote for a Republican President would be to vote for a return to depression, mass unemployment, bank runs, mortgage foreclosures, apple selling, and bread lines. A Republican President was eventually elected, and none of these things happened. On the contrary, our present economic fetish, the gross national product, is now at the highest level on record.

This would be embarrassing for Democratic orators today had not a new slogan, Economic Growth, come to their rescue. Sure, the economy grows; sure, everybody's income gets higher every year, automatically; you can hardly prevent it. But our economic "rate of growth" just isn't what it ought to be. The Republicans are holding it down, because they lack vision and are cold-blooded. Elect us to office, and watch things hum!

Anybody who thinks this is a caricature need merely read the full text of Senator Kennedy's Labor Day speech in Detroit. He was very specific: "With an average rate of growth in this country every workingman in the last eight years would have received \$7,000 more than he has received for an education, or a new house, or a rainy day, or his old age. With a really healthy rate of growth this country can have full employment for all who want a job." How to get this \$7,000 and this rate of growth? Simple: "Elect an administration that will do something about it."

### HOW TO RETARD GROWTH

The senator didn't bother to explain just what this "something" would be. The only specific hint he threw out is that he would halt "this high-interest-rate policy." But American interest rates today are among the lowest in the world. And the chief effect of the cheap-money policy under the New and Fair Deals was to produce or aggravate an inflation that cut the purchasing power of the dollar in half.

Kennedy never mentioned any policy that really might increase our rate of growth such as less drastic graduated income taxes to give more incentive to production, or sensible tax allowances for depreciation to encourage more new capital investment by corporations. Perhaps the crowning irony of the whole "rate of growth" agitation is that the people who insist most on faster growth demand policies least likely to promote it.

Kennedy's Labor Day speech was no more convincing in its "facts" than in its theories. Take "Fact No. 1": "Our economy, under the first six years of the Republican Administration, grew one-half as much as under the last six years of the Truman Administration."

### THAT TRICKY GNP

Why the last six years of the Truman Administration? Why not the first six? In 1944, the year before Mr.



Truman came into office in April 1945, the official figure of the gross national product (as measured in “constant” 1959 dollars to eliminate the effects of more price inflation) was \$366 billion. In 1945 it fell to \$360 billion. In 1946 and 1947 it was down to \$316 billion each year. In 1950 it was still only \$356 billion.

In other words, in the first six years of the Truman Administration, the GNP actually *fell* in real terms. In 1952, the year before Mr. Eisenhower took office, the GNP was \$399 billion. This rose to \$451 billion in 1958, to \$482 billion in 1959, and is currently running close to \$500 billion.

The trick of Kennedy’s “rate of growth” comparison is that it was measured from the low point to which GNP fell in 1947. The rise to 1952, incidentally, was caused in large part by Korean-war expenditures. In fairness to Mr. Truman, the decline in GNP after 1945 was also largely the result of the decline from Federal World War II expenditures. Consumers were not less well off in 1947 than in 1944; the contrary was true. But all this only shows how artificial and tricky these GNP “rate of growth” comparisons can be.

The broader question raised by Senator Kennedy’s Labor Day speech, and its crude lure of “\$7,000 for every working man,” is whether he himself understands the facts as little as his remarks indicate, or whether he merely has a low opinion of the voter’s intelligence. ❁

## False Internationalism

October 3, 1960

The irresolution of our own spokesmen and officials, in the face of increasingly brazen Communist aggression and insults, has caused a deep uneasiness in the American people. This uneasiness is now reflected even in the trend of business and the security markets. Neither Presidential candidate has come to grips with the issue. Nixon seems to be the prisoner of his position, bound to defend the Eisenhower Administration’s every act or failure to act. Kennedy seems to suffer even more than the Administration from an appeasement ideology, typified by his remark that the President should have “expressed regrets” to Khrushchev for the U-2 flight, and promised not to do it again.

The truth is that the so-called internationalism that not only we but politicians of the whole West have been preaching and practicing for the last fifteen years is a false internationalism. It has put mere organization above principle. It should have been obvious from the beginning that no organization of which the

Communist states were members would be allowed on net balance to promote world peace and justice.

## TIME TO REEXAMINE

Whether our proper course now with respect to the United Nations is to try to expel the Communist countries from it, or to withdraw ourselves and form a union of non-Communist democracies, or merely to cease to be the U.N. host country, does not come within the purview of this column. But our attitude to the world economic bureaucratic machinery we helped to set up is directly relevant to our economic future. It is time to reexamine our premises.

It is time to ask whether we should continue to pour out billions of aid to subsidize foreign governments and their socialist planning. It is time to ask whether this aid in fact accelerates world economic growth or retards it. It is time to ask whether there is any real need for the International Monetary Fund, or whether this institution has not merely prolonged worldwide inflation and fiscal irresponsibility. By sanctioning arbitrary official valuations of irredeemable paper currency and automatic borrowing rights, and conniving at devaluations of scores of currencies, it has reduced the pressure within each country for monetary discipline, for free and full convertibility, and for making that country credit worthy.

The World Bank is the best of all these postwar official international institutions, but because it is an intergovernmental institution it inevitably subordinates economic to political considerations in its decisions concerning which countries and which projects shall have credit.

## FREEDOM ABRIDGED

It is no accident that all the international commodity agreements, whether in wheat or metals or sugar, resort to a complicated set of rigid import or export or production quotas that try to *freeze* the situation and prevent the natural competitive forces from operating. These agreements clearly cause more economic disruption than they cure.

Finally, such regional institutions as the European Common Market, though they reduce tariff barriers and increase trade among their own members, tend to increase tariff barriers and to disrupt trade with non-members. Everything valid that the Common Market or the Free Trade Area seeks to accomplish could be accomplished better if each nation simply reduced its own tariff and restored the most-favored-nation principle.

What the world today calls “internationalism” is really interstatism, intergovernmentalism. It is a set of barriers, compulsions, prohibitions, and controls administered by an international bureaucracy. True economic internationalism is the internationalism that came close to realization before World War I. It is the freedom of individuals in all lands to deal freely with each other, to buy from and sell to each other, to lend to and borrow from each other, to exchange each other’s currencies at whatever rates they can mutually agree upon, and to do all this without having to run to some nationalistic-minded government bureaucrat for a special license for every transaction.

Is it utopian to think that we can begin once more to move toward this international freedom. ☸

## American Abdication?

October 10, 1960

In his speech before the U.N., President Eisenhower came close to abdicating American responsibility and power and putting our consciences in the hands of other nations. “Only through the United Nations organization and its truly democratic processes,” he declared, “can humanity make real and universal progress toward the goal of peace with justice. . . . The United States stands squarely and unequivocally in support of the United Nations and those acting under its mandate.” This seems to pledge ourselves in advance to support every U.N. decision and action, wise or unwise, moral or immoral.

On Jan. 10, 1957, former Secretary of State Dean Acheson, not commonly regarded as an “isolationist,” observed to Congress, concerning what he even then considered an Administration tendency to pass the buck to the United Nations, that the U.N. is only “a forum. And if a great nation like the United States looks to the United Nations to form American policy, instead of fighting in [and outside?] the United Nations for what the American Government believes should be done, then we have committed an unprecedented abdication of responsibility and power.”

### ‘A FOOL’S PARADISE’

About a month before that, Viscount Cherwell, a nuclear scientist, declared in the House of Lords: “I hate living in a fool’s paradise, and though, like everyone else, I wish the U.N. could work, I have come reluctantly to the view that in its present form it cannot.” He went on to point out that in the Assembly, “the ultimate

governing body of the U.N. . . . 5 percent of the world’s population can carry the day against the other 95 percent; and 10 percent could claim a two-thirds majority. . . . Half the population of the world is represented by four delegates, the other half by 75.” It is “nonsense,” he concluded, for nations to submit their “vital interests to a body so absurdly constituted.”

That the situation has been improved by the additions since that time may be doubted. Among the seventeen new nations just admitted to the U.N. are Cameroon, Niger, Gabon, and Chad. Those four can now outvote the United States, Britain, and France.

We do not need to ask, as a purely hypothetical question, what will come of putting our conscience in the hands of other nations. We already know. Going along with the Organization of American States, we have just broken off diplomatic relations with the Dominican Republic, because it is ruled by a “dictator,” but have not dared to break off relations with either Castro, who daily seizes American property, arrests our citizens, and vilifies us, or with Khrushchev, the butcher of Hungary, who sanctioned, in the President’s words, “the shooting down of American aircraft last July 1 over international waters, the apparent killing of four of its crew members, and the imprisonment of two others on trumped-up spy charges.”

### WHY WE LOSE FACE

Because we lack courage even to break off relations with our sworn enemies, and because they are all in the U.N., we are obliged to admit them here, give them police protection, give them use of our own unparalleled communications channels to broadcast their hate campaigns against us, and treat them with all the punctilio that protocol demands. Of course we continue to lose face in the world. Have we also lost our national self-respect? Or are we sleepwalking in some utopian dream, wandering around in a moral fog?

The only solution the Administration can seem to think of for every problem in South America, Asia, Africa, or wherever is to give away more of the American taxpayers’ money in “aid.” Now we are to give it away through the United Nations, at the behest of the Secretary-General. Meanwhile we ignore the heavy deficit in our balance of international payments as a result of our foreign aid, or the renewed outflow of our gold as a result of this and our cheap-money policies. We have forgotten that the greatest service we can perform for world economic stability is to keep ourselves strong, and to keep the American dollar above suspicion. It is a disservice to the free world to allow confidence in the dollar to be undermined. ☸

## How to Lose an Election

October 17, 1960

Those who followed the election of 1948 must be struck by the parallel between the campaign conducted by Governor Dewey then and that conducted by Vice President Nixon this year. The present commentator, turning back to his own record of events, finds the parallel even closer than he had remembered.

Let us begin with the overall strategy. Commenting in *Newsweek* of Nov. 15, 1948, on the reasons for Dewey's defeat, I wrote: "He assumed that he already had a comfortable . . . lead, that the way to hold it was simply not to make any mistakes, and that the way not to make any mistakes was not to take any stand that would cost him any of his supporters. The result was that he repeated tediously high-sounding truisms about national unity and that he failed to debate the merits of a single major issue. He avoided all the little errors only by making the one tremendous error that defeated him."

I went on to point out how he had thrown away all his real issues: "He never hinted, except in the vaguest generalities, how he would halt inflation. On New Deal policies such as farm parity payments, social security, public housing, and Federal minimum wages, he adopted a me-too attitude that many of his opponents thought was insincere and that many of his supporters hoped was insincere."

### ROAD TO NOWHERE

Dewey never seemed able to analyze his own mistake. He implied he had lost because the Republican record had been too conservative. I commented on this in *Newsweek* of Feb. 21, 1949: "What he fails to see is that the most fatal course of all is precisely the sort of 'middle road' he recommends one in which the Republicans accept the basic premises of the New Deal but allow themselves to be outbid in their application."

It is astonishing how even the detailed issues and positions of 1948 parallel those of today. Dewey accepted the New Deal thesis that the country owed the farmers a living. But "his belated and halfhearted acceptance of the 'parity' nonsense made them suspect that he and the Republicans would offer them less of the taxpayer's money than Mr. Truman." Today Nixon repudiates the Benson farm program for one that he admits would be more expensive at the start but he offers smaller handouts than Kennedy does.

Next (in 1949): "Can the Republicans hope to win if they endorse the principle of Federal minimum-wage laws but offer only 65 cents an hour instead of 75 or only 75 instead of \$1?" Or, in today's terms, only \$1.15 instead of \$1.25?

Next (in 1949): "Can the Republicans hope to win if they come out belatedly for building private housing at public expense but offer only 500,000 units instead of Mr. Truman's 1 million? Why so little of a wonderful thing?" The parallel today applies not merely to housing but to Federal aid to local public schools, and a score of other spending projects.

### ME TOO, BUT—

Finally I came to social security, which Dewey had accepted in principle though drawing back from too much of it. Here again his attitude versus the Truman proposals of that time has been closely paralleled by Nixon's attitude toward Kennedy's old-age medical-care program today.

What is truly amazing is that Nixon, with the record of the Dewey campaign before him, should seem so bent on repeating it. He has yet to point out why any major Kennedy proposal is wrong in principle.

Nixon's program so far, in brief, seems strangely like Dewey's in 1948.

"Me too—but not as much." It is the perfect formula for defeat. It throws away the principle, but reduces the size of the bribe. It loses votes at both ends of the political spectrum. The pressure groups vote against it because the other side offers them more. The conservatives, the taxpayers, those who fear inflation or have faith in the free market, become apathetic or indifferent. It is not true that they have "nowhere else to go." As the 1948 election proved, they can stay home in droves. If they are to be aroused and got to the polls, they must be convinced that they have a clear-cut alternative worth voting for. There is still time for Nixon to offer it to them. ❁

## What Are We Deciding?

October 24, 1960

What are the central issues that will be decided in this election? The best way to find the answer is not through the TV "debates"—which seem mainly designed to show how quick each candidate is on his feet, and how he can handle, in two or three minutes, the particular curve thrown to him by a reporter—but by imagining the victory of either candidate, and asking ourselves what its probable sequel would be.

A victory for Kennedy would first of all be interpreted as a repudiation of the record of President Eisenhower, both in foreign and domestic policy. It would above all be interpreted as a repudiation of practically every element in his domestic policy that



is conservative, noninflationary, or in the direction of fiscal prudence.

For the Democratic platform is an out-and-out left-wing document. It was drafted to reflect Kennedy's ideas. He supports all its extreme proposals. He starts from the premise that the taxpayers and food consumers owe the farmers a living, at "full parity levels," regardless of the conditions of supply and demand. This parity income is to be achieved even if it involves not only permanent subsidies but permanent controls over what the farmer plants and sells.

### STRIKE VIOLENCE

Kennedy has not dared to differ on any important point from the country's big labor bosses, especially Walter Reuther. They, in effect, dictated the labor planks of the Democratic platform. What this will mean in practice can be seen from a glance at the current General Electric strike. The International Union of Electrical Workers, AFL-CIO, has thrown picket lines around 55 plants. Around GE's biggest plant, at Schenectady, the union threw a mass picket line of 3,500 strikers, "shoulder to shoulder and belly to back," to prevent those who wanted peacefully to continue to work from doing so. If Kennedy sees anything wrong with such lawless violence he has neglected to make his view known.

The Democratic platform is a pledge to impose the total welfare state. It promises bigger spending in every direction—housing, education, farm subsidies, old-age medical care, public power. Vice President Nixon has estimated that it would increase total Federal spending by \$13.2 billion to \$18 billion a year. Kennedy has denied this, but on the Oct. 13 TV debate failed in answer to a direct question to supply his own total. Instead, he professed to believe, like the Democratic platform, that his huge new spending program could be financed with a balanced budget and without inflation. But as his spending promises can hardly add up to less than \$10 billion more a year, he owes it to the voters to tell them what additional taxes he proposes to impose to raise it.

### TENDENCY TO RETREAT

As to foreign policy, we find that, wherever Kennedy has turned from vague generalities to specific proposals, he has shown a tendency toward retreat and appeasement. His preference for advisers like Stevenson and Bowles, his suggestion that the President should have halted the U-2 flights earlier and expressed regrets to Khrushchev, his opposition to United States resumption of underground nuclear tests, his suggestion that we should publicly declare in advance that we have no intention of defending Quemoy or Matsu—all point in the same direction. If we were to surrender Quemoy

and Matsu chiefly because they were "militarily indefensible," what would become of the case for standing firm on Berlin?

If the implications of Kennedy's election were more widely understood, that election would be improbable. Why is it, then, that his chances today seem at least even? The reason is that Nixon has failed to make the issues clear. He has not supplied a sufficiently clear-cut alternative. True, on a few questions—the U-2, Quemoy and Matsu, the error of attempts to force "economic growth" by cheap money and inflation—Nixon has spoken out. But he will have to speak out much more clearly for a firm and unequivocal foreign policy, for encouragement of private enterprise, and against big government, big spending, inflation, labor violence, and the total welfare state, if he hopes to win. ☸

## The Dollar Crisis

October 31, 1960

The present dollar crisis was immediately precipitated by the irresponsible spending and soft-money promises in the Democratic platform and in the speeches of Senator Kennedy, combined with an increasing fear that he may be elected.

But the dollar has been in an increasingly precarious position for the last two years. We have had a heavy deficit in our balance of payments and a heavy gold loss. As a result of unbalanced budgets, huge foreign-aid programs, inflation, and cheap-money policies, our gold holdings have dropped from \$24 billion in 1949 to \$18 billion. Our short-term liabilities to foreigners (payable in gold if their central banks demand it) exceed our entire gold reserve. They have risen from less than \$8 billion in 1949 to more than \$20 billion today.

The Democrats in Congress have done everything to undermine confidence in the dollar still further. They refused the President's request to repeal the legal interest rate ceiling of 4 percent on long-term bonds, thus forcing more inflationary short-term financing. The Democratic platform, instead of giving assurance of economy, has proposed huge new expenditures in every direction. Nixon has estimated the increased expenditures it proposes at from \$13 billion to \$18 billion a year. Kennedy has refused to attach any price-tags to his promises and has said nothing about what taxes he would boost. At a time when our interest rates have been kept relatively too low, he has accused the Republicans of following a "tight" money policy. This is a demand that our interest rates be forced even lower.



### PARALLEL WITH 1932

The integrity of the dollar can be protected, it can be kept on a gold basis at \$35 an ounce, only if Kennedy immediately gives the strongest assurances that, instead of increasing nondefense expenditures, he will strive to cut them; that he will never seek either to overrule the Federal Reserve Board or to force it to follow cheap-money policies; and that, instead of agitating for still cheaper money, he will support monetary discipline firm enough to assure the outside world that we mean to maintain the dollar. Such assurances would require a complete reversal of the policies he has hitherto espoused.

There is an ominous parallel between our inflation crisis today and the deflation crisis between the defeat of President Hoover in November 1932 and the inauguration of President Roosevelt in March 1933. It was in this four-month interregnum that the great bank runs developed.

### HOOVER AND F.D.R.

Hoover, in his memoirs, has given a detailed account of his persistent but futile efforts to get the cooperation of Roosevelt in halting the degeneration of confidence. Despite Roosevelt's specific assurances prior to the election, there were spreading fears that he was determined to abandon the convertible gold standard for a managed currency or devaluation. There was a foreign run on our gold. In February, Hoover sent a confidential letter to Roosevelt declaring that it "would serve greatly to restore confidence" if "a very early statement by you" would give "prompt assurance that there will be no tampering or inflation of the currency; that the budget will be unquestionably balanced; . . . that the government credit will be maintained. . . ." No such reassurance was given.

The present crisis, of course, cannot be blamed on the proposed policies of Senator Kennedy alone. Behind the dollar crisis today lie years of wrong policies and irresponsibility on the part of both political parties and of the Federal Reserve System. The World Monetary Fund was set up without understanding of the terrific load it put upon us. It made the American dollar, in effect, support all other currencies. Our foreign-aid program was launched and expanded with no thought of the great pressure it would put upon the dollar. Federal "welfare" expenditures have been steadily increased. Our Federal Reserve authorities have pushed interest rates below the level necessary to prevent inflation, gold loss, and loss of confidence in the dollar.

If the dollar is to be saved, it can only be by courageous monetary policies and the united determination of the leaders of both parties. ❁

## How to Restore Poverty

November 7, 1960

Senator Kennedy's choice of John Kenneth Galbraith as his chief economic adviser provides a clear warning of what Kennedy's economic policies, if he became President, would be like.

The professor once exercised power. He was deputy price administrator in the OPA under Roosevelt in 1942 and 1943. Leading members of the food industry protested that he was primarily responsible for pricing regulations that had "strangled" their operations and produced "utter confusion and chaos in the production and distribution of the nation's food supplies." Leading members of Congress joined in demanding his resignation, which they finally forced in May of 1943. The professor still believes in price controls. He still believes he knows better than the free market just what prices ought to be.

The flavor of Galbraith is best conveyed in an often-quoted paragraph from his book *The Affluent Society*:

"The family which takes its mauve and cerise, air-conditioned, power-steered, and power-braked automobile out for a tour passes through cities that are badly paved, made hideous by litter, blighted buildings, billboards, and posts for wires that should long since have been put underground. . . . They picnic on exquisitely packaged food from a portable icebox by a polluted stream and go to spend the night at a park which is a menace to public health and morals."

### ARE WE TOO RICH?

If we accepted this extravagant caricature as accurate, what would it prove? According to Galbraith it proves that the problem of production is not only solved but oversolved. Capitalism is so productive that production is running wild. The American people have become too rich and affluent for their own good. The people who earn the money spend too much of it on themselves (the "private sector"), whereas it should be seized from them in taxes and spent by the politicians and bureaucrats (the "public sector").

Actually the picture that Galbraith paints of American life seems a damning indictment of his own proposals. It would mean that for the money they spend on the private sector the American consumers get marvelous products and amenities never dreamed of before

in human history. But though they are forced to spend more both absolutely and proportionately on the “public sector” than ever before in history, they are wretchedly served, because political spending is inherently improvident, inefficient, and wasteful. Yet Galbraith, in the face of the statistics, blandly blames it all on insufficient funds.

### CONSUMERS AS DUPES

His whole program rests on an inner contradiction. It assumes that people are individually unfit to spend the money they themselves have earned, but somehow collectively competent to choose wisely the officeholders who will seize their money in still more onerous taxes and spend it for them. People as voters are supposed to have sense and wisdom; the same people, as consumers, are boobs, gulls, suckers who can be pushed into buying whatever Madison Avenue wants them to buy. Galbraith laughs at the idea of thinking such people worthy to retain the liberty to spend their earnings as they see fit. His conclusions remind me of de Tocqueville’s remark that “the taste a man shows for absolute government bears an exact ratio to the contempt he professes for his countrymen.”

I have discussed only Galbraith’s central contradiction. There is no room to discuss his lack of originality. Or his completely inverted ideas on inflation. Or his strange assumption that “goods” and “income” are two entirely separate things instead of two names for the same thing. Or his scheme for making unemployment perpetual and universal by paying everybody seven-eighths as much for not working as for working.

One thing, however, must be conceded. According to Galbraith, the great evil today is too much unneeded production. His schemes are certainly calculated to cure this. He would reduce or destroy every incentive to production and pay extravagant bonuses for malingering and idleness. His program would halt this demoralizing affluence and restore a noble and uncorrupted poverty. ❁

## Conventional Heretic

November 14, 1960

In the last issue, space did not permit me to discuss certain aspects of the doctrine of J.K. Galbraith, present idol of the left. Further examination seems warranted.

The professor is nothing if not ironical; he is a fountain of perpetual paradox; and I do not get the impression that he cares very much whether or not a given proposition is true. He is out to *épater le*

*bourgeois*, to demonstrate his iconoclasm, his superiority to what he disdainfully calls “the conventional wisdom.” But his claims to originality have been shown to be groundless. David McCord Wright has pointed out that Galbraith’s basic argument is simply an expanded rehash of one of Keynes’s essays, “Economic Possibilities for Our Grandchildren.” George Schwartz of *The London Sunday Times* has pointed out that 130 years ago, Southey, in his “Colloquies on Society,” was proclaiming that a people may be too rich but a government cannot be:

“A state cannot have more wealth at its command than may be employed for the general good, a liberal expenditure in national works being one of the surest means for promoting national prosperity; and the benefit being still more obvious of an expenditure directed to the purposes of national improvement. But a people can be too rich.”

### BACK TO MERCANTILISM

I myself am tempted to trace the “Galbraith” thesis as far back as 1705, two generations before the appearance of Adam Smith’s *The Wealth of Nations*, to Mandeville’s “Fable of the Bees,” in which that satirist argued that jobs depended on the production of needless luxuries for the rich. The heretical Galbraith, like the heretical Keynes, ends by sliding back into seventeenth-century mercantilism.

It is interesting to notice one reason why he does so. Adam Smith considered it “too ridiculous to go about seriously to prove, that wealth does not consist in money . . . but in what money purchases.” Say and Mill pointed out that, when we remove “the monetary veil,” we find that we buy goods with other goods; each buys the production of others with his own. But Galbraith, whose disdain of the classical economists apparently caused him to skip the beginners course, never learned this elementary lesson. He treats “goods” and “income” as two entirely separate things. The “income” that men get from the production of “goods” he insists, is vital; but the “goods” themselves are excessive and unimportant.

What on earth is his concept of “income”? Is it paper dollars, which we could turn out on the printing press to any desired amount? Or is it not precisely the output of goods and services?

### PLANNED IDLENESS

Galbraith praises unemployment compensation because “it provides income apart from production.” (My italics.) Hence his preposterous scheme to pay workers, as soon as unemployment gets beyond 4 million, seven-eighths as much for staying idle as for working at a job. How

this enormous handout would be paid for, who would work under such conditions, how much goods would be produced for anybody to consume, and what the purchasing power would finally be of dollars handed out to promote nonproduction, seem to him problems hardly worth considering.

The old socialist contention was that the poor were getting poorer and that capitalism could not get optimum production, could not deliver the goods. Galbraith abandons this argument. He admits that production in the United States today far exceeds the most utopian dreams of the past. But instead of asking himself what has wrought this miracle—instead of examining the role of free markets and free enterprise, of competition for the consumer's dollar, of incentives to production, of capital accumulation—takes it all for granted, as if it happened automatically, and would automatically continue, notwithstanding his own plans for drastic taxation, socialized spending, redistribution of income, and planned idleness.

Galbraith has overlooked one of the oldest discoveries of the conventional wisdom: That the workers of the world have enormously more to gain from continuous increase in per capita production than from any conceivable redistribution. ❁

## To Maintain the Dollar

November 21, 1960

The most urgent problem that confronts the President-elect is to remove any suspicion or misgiving concerning the future of the American dollar. This issue cannot be postponed until he takes office on Jan. 20. It must be met now. For the dollar and gold are being traded in on every business day in the markets of the world. Their movements between countries, and the quotations on them, will be governed in the next nine weeks not only by what "speculators," but investors, importers, exporters, and the great central banks think is going to be done about the dollar by the new Administration.

The first need, therefore, is for Mr. Kennedy to reaffirm the pledge he gave during the campaign not to "devalue the dollar from the present rate." There are several reasons why this reaffirmation is necessary.

The first is to reassure all foreign governments and banks and holders of dollar assets everywhere that the pledge of Oct. 30 was not merely something said to win an election, but a deep determination that can be reiterated now that Mr. Kennedy has nothing to gain from doing so but his country's honor and prestige.

## NO REPETITION OF '33

What must be at all costs averted is a repetition of what happened between the election of 1932 and the transfer of power on March 4, 1933. On Nov. 4, 1932, four days before the election, Franklin Roosevelt declared in a major campaign speech at the Brooklyn Academy of Music:

"One of the most commonly repeated misrepresentations of Republican speakers, including the President [Hoover], has been the claim that the Democratic position with regard to money has not been made clear. . . . The businessmen of the country, battling hard to maintain their solvency, were told in blunt language in Des Moines how close an escape the country had some months ago from going off the gold standard. But that, as has been clearly shown since, was a libel on the credit of the United States. . . . No responsible government would have sold to the country securities payable in gold if it knew that the promise, yes the covenant, was as dubious as the President of the United States claims it was."

Yet when President Hoover after the election tried in a confidential letter to get President-elect Roosevelt to give "prompt assurance that there will be no tampering or inflation of the currency" the President-elect refused to give it. Indeed, he refused all cooperation in the interregnum period on the ground that "it would be unwise for me to accept an apparent joint responsibility with you when, as a matter of constitutional fact, I would be wholly lacking in an attendant authority."

## ROLE OF THE FED

Notwithstanding his pre-election pledge, Roosevelt, a few days after his inauguration, asked for and got emergency powers not merely to go off the gold standard, but to make it unlawful for any American to own gold or gold coins, gold bullion, or gold certificates.

That is why a reassertion of the pre-election gold pledge of Mr. Kennedy is so essential now to maintain confidence in the dollar. But while such a reassertion is necessary, it is not enough. Mr. Kennedy must also give assurance that the policies he intends to follow on government spending, taxes, avoidance of deficits, non-interference with efforts of the Federal Reserve to maintain monetary discipline and anti-inflationary interest policy will be such as to make the pledge meaningful.

Responsibility is not, of course, wholly upon Mr. Kennedy to maintain confidence in the dollar. The Eisenhower Administration must co-operate to the full. Above all, the Federal Reserve authorities must co-operate. It was highly unwise of them to reduce the discount rates from 4 to 3½ percent in June, and still more



unwise of them to reduce it from 3½ to 3 percent in August. These reductions did not stimulate American business; they chiefly caused further loss of gold, further loss of foreign confidence in our determination to maintain the integrity of the dollar. The discount rate should be restored to 4 percent, both as a practical measure and as a symbol of that determination. ❁

## A Meaningful Opposition

November 28, 1960

Associates of Senator Kennedy contend that in view of his religion and youth, and the fact that he was running at a time of peace and relative prosperity, his triumph was “miraculous.” When we add other handicaps that they do not mention, above all the extreme leftism of the Democratic platform, the Kennedy triumph seems indeed a miracle.

But the chief architect of that miracle was not Kennedy but Nixon himself. He lost the campaign because he lost the debate. Did he lose it because he was not, after all, a first-rate debater? Or because he did not basically understand the chief political and economic issues? Or because he lacked the courage to state his convictions because he was timid and opportunistic? I do not pretend to know the answers.

But for whatever reasons, he never stated the real case against Senator Kennedy. And when a candidate for the Presidency fails to make the case, nobody else can make it for him. The real issues were clear enough. They included the apparent Kennedy softness toward Soviet Russia and Communist aggression (as reflected both in his stand on Quemoy and Matsu and on expressing regrets to Khrushchev for the U-2); Democratic platform extremism on civil rights, and such economic issues as the Kennedy farm program and his big spending and soft-money policies.

### BLUNTED ISSUES

Nixon seemed more anxious to blunt these issues than to drive them home. He kept trying to reduce the issue to a purely personal one. Choose between the two men. Which has the “experience”? Perhaps, as many think, the campaign was decided on the first television debate, when Nixon declared that he and Senator Kennedy had the same “goals,” and differed only as to “means.” And Nixon, for the most part, stood by this error. He treated his opponent with deferential politeness. He seemed to be intimidated by his implacable enemies; and afraid of being called “the old Nixon.”

So the campaign he followed remained to the last curiously like the Dewey campaign that had failed so disastrously against Truman. I described this parallel (*Newsweek*, Oct. 17: “How to Lose an Election”) as it had already been drawn early in October. Its basic formula on all leading economic issues was “Me too—but not as much.” Even when fears of a Kennedy victory led to a discount on the dollar in the London gold market, Nixon appeared to have no realization of its full significance, and made only a few perfunctory references to it. It was Kennedy who set the “issues”—economic growth, military strength, American “prestige.” He succeeded in keeping Nixon on the defensive.

### NOT THE SPOKESMAN

It is only natural that many of us should feel sorry for Nixon on personal grounds. He conducted a campaign on a high level of courtesy and absence of personal abuse. He gave himself without stint to an incredible expenditure of physical energy. He fought against the handicaps of the laxness and ineptitude of the Eisenhower Administration in dealing with Khrushchev and Castro, and the gratuitous campaign blunders of Henry Cabot Lodge.

But when all this has been conceded, it is still clear that Nixon cannot be the spokesman of the opposition in the next four years, nor the formulator of Republican doctrine and policy, nor its next prospective candidate for the Presidency. If he could not win as the Vice President, backed by an Administration in power, how could he hope, as a man out of office, to win against a Kennedy Administration in power? More important, if he did not know how, or did not want, to state the case during the campaign against big spending, higher taxes, budget deficits, cheap money, and the total welfare state, how can he be expected to do so in the next four years?

It is the Republicans in office, and specifically the Republicans in Congress, who must now choose their leaders and formulate a positive policy. This policy must be what is now called conservative—that is, it must be a policy of limited government and sound money, or the name Republican will become meaningless. We do not need two parties to enforce inflation and the welfare state. ❁

## Wrong Dollar Solution

December 5, 1960

It is the view of the Administration that the recent gold and dollar outflow has been caused by “a deficit in the American balance of payments.” Consequently the remedies that the Administration is proposing—such



as reducing the expenditures of our troops and their families abroad, or getting other nations to assume a greater share of the foreign-aid burden—are directly designed to reduce this “deficit.” But the diagnosis is mistaken and the proposed cure does not go to the heart of the problem.

“A deficit in the balance of payments” means the excess of our total payments to foreigners (for imports, tourism, long-term investments, etc.) over total receipts from foreigners (from exports, etc.). This excess is *defined as* and *measured by* our loss of gold and liquid dollar assets.

A fallacy occurs when it is tacitly assumed, as in most current discussion, that everything else in the “balance” (commercial imports, exports, etc.) is the result of intentional decisions by Americans or foreigners, while only the movement of gold and dollars is not intentional but merely the passive and unavoidable result of the other decisions. This is not true. The decision of foreigners to use their dollar credits (whether they got them from exports to us or from foreign aid) to buy goods from us, or to leave them here as dollar deposits, or to demand gold for them, is just as intentional as any other decision.

#### WHICH IS ‘CAUSE’?

It is not correct, therefore, to call the “deficit in our balance of payments” the cause of the gold or dollar outflow. The causation may be the other way round. A run on our gold would “cause” an increase in the balance-of-payments “deficit.” In fact, our loss of gold and dollars, and a deficit in the balance of payments, turn out to be simply two names for the same thing.

Our problem is only partly the result of our foreign-aid program. If our payments were otherwise in balance, and we gave away some \$4 billion a year in foreign aid, then, if foreigners elected to take all this in the form of gold and dollars, we would have a deficit of \$4 billion a year in our balance of payments. But this is unlikely to happen. If the rest of the world uses \$3 billion of this to buy more goods from us, our resulting deficit is only \$1 billion. Similarly, even if we pay \$2 billion a year for our troops to spend abroad, some of the dollars they spend are likely to be used by foreigners to buy American goods, so reducing our net deficit.

#### TO RESTORE CONFIDENCE

Even if we were to cut down on our foreign troops or cut our foreign aid entirely, therefore, it does not follow that we would reduce our balance-of-payments deficit by the same amount. For we would not then be giving the rest of the world the added dollars to buy our goods. Of course our foreign-aid program does intensify

our dollar problem. If our prices are not kept competitive, foreigners will use their dollar aid to drain our gold rather than to buy our goods. And if our foreign-aid program increases inflation here (by adding to budget deficits, for example), it works to undermine faith in the dollar.

The determining factor is, at bottom, the world’s faith in the dollar—faith that we do not intend to inflate or devalue, faith that our gold supply is great enough in comparison with the foreign claims on it to meet all demands. It is precisely this faith that we have been shaking. While the Eisenhower Administration busies itself belatedly with a fringe problem, the Federal Reserve has failed to take the measures necessary to assure foreigners that we have set our face against cheap money and inflation. And the President-elect, according to a report in *The Wall Street Journal*, “is preparing a series of possible moves to counter” feared unemployment in January, including “increased and faster Federal spending, more loans to small businesses at lower interest rates, and lower interest-rate ceilings on government-guaranteed housing loans. . . . Mr. Kennedy is fully prepared to set aside hopes for a balanced budget in favor of Federal stimulation of the economy.”

These plans to spend and inflate are the exact opposite of the assurance the world needs regarding the integrity of the dollar. ❁

## In the Wrong Direction

December 12, 1960

Within the next few weeks or months we may be forced into major decisions regarding gold and the dollar. It is vital that whatever decisions we make should at least be in the right direction.

That is why the proposals made by Henry C. Alexander, chairman of the board of the Morgan Guaranty Trust Co. of New York, in a speech before the Investment Bankers Association on Nov. 28, are a cause of concern. Alexander’s position and standing may give these proposals great influence, and yet they would take us, I believe, in the wrong direction. They would tend to encourage further inflation.

Two in particular call for discussion. The first is that we repeal even the present requirement that the Federal Reserve Banks keep a 25-percent reserve in gold against their note and deposit liabilities. (Until 1945 the required reserve ratios were 35 percent against deposits and 40 percent against notes.) The second is

that we continue to forbid American citizens to own gold at home and even forbid them to own it abroad.

### THE LAST VESTIGE

The proposal that we abandon even the 25-percent gold reserve requirement was made a year ago by Roy L. Reiersen, vice president and chief economist of the Bankers Trust Co. of New York. I discussed it in *Newsweek* of Dec. 21, 1959, and Jan. 11, 1960. As Alexander makes substantially the same arguments for it, we may repeat the same answer. By taking this step, we would drop the last vestige of a domestic gold standard. We would, at best, keep the dollar good for foreigners for a while longer at the cost of permanently undermining its value for Americans. We would remove even the feeble restraint against inflation that a 25 percent gold requirement has exercised on our monetary managers.

When those monetary managers asked Congress in 1945 to lower the gold reserve requirements from 35 and 40 percent to 25 percent, they did so under the plea of war emergency. But though the war ended a few months later, they continued to permit and promote inflation. At the end of 1944, total bank deposits and currency amounted to \$151 billion; today they amount to \$252 billion. The increase of 67 percent in total money supply accounts for the increase of 69 percent in consumer prices in the same period. Monetary managers, under constant political pressure, tend to inflate to the extent that the law permits them to inflate.

Alexander contends that the pseudo gold standard that we improvised in the '30s and formalized with the International Monetary Fund in the '40s "has proved workable." In whose favor? Hardly in that of the pensioners, bondholders, policyholders, and savings-bank depositors who have seen half the value of their savings wiped out.

### WHY HOARDERS?

It is a sign of the extent to which the system has *not* worked that we are now in a gold and dollar crisis. Alexander thinks this can be cured only by removing all gold reserve requirements, and prohibiting Americans even from owning gold abroad. His argument for these measures is that gold "hoarding" by "speculators" or "eccentrics" undermines confidence in the paper dollar and reduces the amount of gold for "legitimate" monetary purposes. But these "speculators" are people who dislike being forced to speculate in a constantly rotting paper dollar. These "hoarders" and "eccentrics" are people trying to protect themselves against further expropriation of their savings by the monetary managers,

whose idea of "legitimate" monetary purposes includes constant inflation.

Alexander rightly insists that "sound money" can only be achieved by "sound, honest, wise fiscal and economic policies." He deplors "submitting to the automatic, unreasoning operation of a gold coin standard with full convertibility here at home." But he seems to forget that it was precisely the function and merit of the full gold standard that it enforced strict limits on the inflationary schemes of the politicians.

What this country faces today is only secondarily a crisis in the "balance of payments." It is primarily a crisis of inflation. Until we halt inflation, our problem is insoluble. ❁

## To Encourage Growth

December 19, 1960

The need to increase America's economic growth is urgent. We must expand our capacity to produce more and better goods in order to raise still further the American standard of living, to provide jobs at rising wages for our growing population, and to retain our economic leadership in an increasingly competitive world.

Yet the most important measure we can take to increase our rate of economic growth has been neglected.

America leads the world today in production per man-hour because it has provided each worker with more and better tools than any other nation. The National Industrial Conference Board estimates that the average capital invested *for each worker* in manufacturing industries in the United States amounts to \$19,300. But today our growth is retarded because we are not replacing our tools of production fast enough to keep pace with the world's rapidly advancing technology and our own economic potential. If we are to *increase* our productivity and maintain our lead over foreign competitors, American industry must invest substantially more than \$19,300 for each new job. In addition, industry must of course put ever new capital, in the form of new and better plant and equipment, behind the *present* workers.

### NEED TO MODERNIZE

In brief, we must give every possible encouragement to new investment by American business. Our rate of economic growth, and even the ability of our industry to hold its own against foreign competition, depend primarily on the volume of new investment—on the replacement of obsolete tools of production with the most modern and efficient equipment.

The main source of capital for new plant and equipment has not been savings of individuals but the savings of corporations themselves out of their profits. And of these by far the largest amount is what the corporations are allowed to set aside each year, free of taxes, for *depreciation*—the wear and tear and obsolescence of existing plant and equipment.

What are needed are tax laws and rulings that will encourage the maximum amount of modernization and new investment. Instead, our tax laws and rulings in this respect are the most restrictive and discouraging of any leading industrial nation. In adequate depreciation allowances and new investment incentives we are far behind Canada, Britain, France, Germany, Sweden, Belgium, the Netherlands, and even Uruguay.

In Germany, for example, tax reform played a central role in the miraculous recovery which began in 1948. Basic industries that replaced equipment were allowed a tax write-off of 50 percent of their whole investment in the first year. This has since been modified slightly because expansion was so rapid, but the allowances are still incomparably more liberal than our own. Write-offs of 25 percent of cost in the first year, and of 58 percent in the initial three years, are common.

#### HOPE OF REFORM

In U.S. industry, however, leading economists and accountants have estimated the costs of replacement are outrunning depreciation allowances by \$5 billion to \$8 billion a year.

But there are grounds for hope of reform. In January of 1960, the Senate Select Committee on Small Business reached the conclusion that: "Present depreciation policies do not sufficiently encourage the expansion of the national economy. Indeed, those policies have, in all probability, stifled economic growth. The twin problems of inflation and technological obsolescence . . . have made our depreciation policies completely out of date."

Even more significant, in a statement on Oct. 30, during the campaign, Senator Kennedy declared: "We must stimulate plant modernization programs which are vital both to increased production and to building industrial facilities which can compete successfully with the modern plants of Europe and the Soviet Union. Wherever we are certain that tax revision—including accelerated depreciation—will stimulate investment in new plant and equipment, without damage to our principles of equity, we will proceed with such revision."

There is no more urgent task before the new Congress than to make this reform in our tax laws. ☼

## To Promote Growth

December 26, 1960

Last week I discussed here the need of tax reform to encourage increased corporate investment in the most modern plant and equipment in order to promote more rapid economic growth and to enable American industry to meet increasingly serious European competition. The most important tax reform in this connection would be to permit more rapid write-offs for depreciation of old equipment.

Suppose you are in the laundry business, and have invested \$5,000 in machinery which has worn out or become obsolete in five years. If you have been allowed to deduct \$1,000 a year for depreciation, and at the end of five years the new machines available to replace the old cost you no more, then you can have both the funds and the incentive to replace your old machinery with new. But suppose the government refuses to allow you to write off your old machines over five years, and says you can only do so over ten, fifteen, or even twenty years? Then you may not have the funds to reinvest at the end of five years, and you will certainly have less incentive to do so.

#### REPLACEMENT COSTS

Even if you are allowed to depreciate your old equipment over five years, or some similar short time, it is improbable, in a period of inflation, that you will be able to replace your worn-out or obsolete equipment at the same dollar cost. It will probably cost you more. That is why, in France today, the government not only allows rapid depreciation deductions against original cost, but revaluations of property to take into account higher costs of replacement as a result of inflation. A like reform here would certainly be desirable, but accelerated depreciation allowances would at least make it less urgent. In a "creeping" inflation, prices of equipment rise less over a short period than over a long one.

If accelerated depreciation has such obvious advantages, if it encourages greater production, lower costs, faster economic growth, why did our government adopt it only for defense industries in wartime? Why does it refuse to permit all industry to make regular use of it?

The stock argument against this has always been that the government would lose revenue. The objection is shortsighted. Perhaps there would be some loss of revenue in the first year or two, but it is difficult to see how there would be any over the long run. A corporation is allowed to deduct, in any case, no more than 100 percent of the amount it has invested in plant or equipment. If it has invested \$1,000 in a given machine, and the government does not change the corporate income

tax rate over the years, what difference does it make to its revenues whether the corporation deducts \$50 a year depreciation over twenty years, or \$200 a year over five years, or \$500 the first year and diminishing amounts in succeeding years? Whatever the government loses in tax revenues in the early years it makes up in later years.

#### INVESTMENT STIMULATED

Of course if the corporation tax rate is *lowered* in later years, the corporations “gain” and the government “loses” by accelerated depreciation. But if (as has, alas, been more usual) the tax rate is raised rather than lowered in later years, the corporations lose and the government gains by accelerated depreciation.

The foregoing calculations ignore, however, an even more important factor. Accelerated depreciation stimulates investment in modernization and new plants. This

modernization increases production, payrolls, and corporate earnings, and so increases tax revenues over the long run.

This has been dramatically shown in Canada, which has far more liberal depreciation allowances than we have. A study by Maurice E. Peloubet, a prominent accountant, has shown that whereas depreciation allowances taken by Canadian corporations in 1959 were more than five times what they were in 1946, corporate profits before deducting either depreciation or taxes had increased three times in the same period. As a result corporate income tax revenues increased nearly two and a half times.

A recent poll by the American Economic Foundation shows that seven out of every ten business and labor economists favor liberalized depreciation. The reform is long overdue. ❁





1961



## A World Super-Bank?

January 2, 1961

As the gold-and-dollar problem increases, and no one in authority wants to take the agonizing corrective steps, everyone tries hopefully to find some painless and easy way out. This accounts for the sudden popularity of two proposals. One is to abandon even the legal 25 percent gold reserve requirement in our Federal Reserve System. The other is the proposal of Robert Triffin of Yale to set up a world super-bank.

The first proposal, already put forward by a few American bankers, has now been blandly endorsed by no less a figure than Per Jacobsson, the managing director of the International Monetary Fund. I have already devoted several articles to trying to show what is wrong with it. It would destroy the last meaningful restraint on credit expansion. Against its paper liabilities our banking system would be required to hold nothing but paper reserves. There would be no further brake on inflation except the arbitrary discretion of our monetary managers. And these would have politicians and labor leaders constantly breathing down their necks demanding more inflation to maintain “full employment.”

### KEYNES PLAN REVIVED

The Triffin plan would turn the International Monetary Fund (IMF) into an international central bank for national central banks. These central banks would be required to keep on deposit at the IMF a minimum of 20 percent of their total reserves of gold and foreign currencies. Against these reserves the IMF could make loans and create deposits, or conduct “open market operations”—in other words, manufacture more money or more “reserves” against which more money could be issued.

In broad outline, this is a revival of the Clearing Union scheme originally proposed by Lord Keynes at Bretton Woods. The Keynes plan was rejected on the sound argument that it would have led to continuous world inflation. Triffin tries to meet this by proposing that his world super-bank should not be allowed to inflate at a rate of more than 3 to 5 percent a year. He does not say what assurance we have that most member governments would not vote, as soon as they got into difficulties, for a much faster rate.

Another objection to the Keynes plan was that it would have meant a surrender of national sovereignty to an international institution. To keep its currency at parity with the world central bank's, every nation regardless of its internal economic or political situation, would have had to inflate as fast as, but no faster than, all the rest. Triffin would apparently meet this

by allowing considerable monetary “independence” to each nation. They could of course have all they want of this now, with no international central bank at all. But if they had this “independence” *with* a world central bank, then the countries that inflated the most would be exploiting the countries that inflated less.

### WHO GETS WHAT?

This calls attention to the central fallacy of the world central bank scheme. It would be a bank in which the U.S. would make the lion's share of the deposits while the “underdeveloped” countries would get the lion's share of the loans. This would mean more foreign aid, though disguised. Even under the IMF, as Triffin admits, the U.S. has been practically “the sole net lender.”

In a world super-bank, there would be endless disputes concerning the distribution of the newly created fiat money among the member nations. These conflicts would probably lead to the breakdown of the whole scheme.

The reason proposals like this are now being seriously discussed is that no one likes to face the alternatives. An embargo on the outflow of gold, or a unilateral devaluation of the dollar, in the sense of a marking up of the dollar-price of gold, would be regarded as a breach of faith by the central banks that hold reserves in dollars. The mere discussion of such plans would precipitate massive anticipatory speculation and a crisis.

An indispensable part of any real cure would be a complete halt to our inflation. As prevailing opinion thinks that inflation is necessary to maintain employment, nobody likes to face this. That is why we listen to siren voices assuring us that the cure for the evils of past national inflation is more world inflation. ☸

## Are We Going Left?

January 9, 1961

The new Administration is already laying plans for a program of Federal medical care for the aged, tied to the social-security program, for Federal aid to education, a Federal housing program, a rise in Federal minimum-wage standards, and “redevelopment” of “economically depressed areas.” All these proposals mean more Federal intervention, more concentration of power, more spending, more taxing, more paternalism, more statism.

Yet all this was determined by the thinnest of margins—a plurality of 112,801 in a total vote of 68,832,670. Kennedy's percentage of the major party vote was 50.1



to Nixon's 49.9. Of the total vote for President, Kennedy received a minority: 49.7 percent to Nixon's 49.6.

But in the American system, the winner by no matter how hairline-thin a margin, takes all. If we had a Cabinet system, as in Britain, everything would depend on the margin in the legislature. The government might have to resign if the vote on a single important bill went against it. This would make it cautious. But the Kennedy Administration will be able to introduce or push any legislation with comparative impunity. On this basis the prospect is that conservative Republicans and Democrats, though they may succeed in modifying some extreme measures, will merely fight a slow defensive retreat.

### CONSERVATIVE SHOWING

There are, however, two other elements in the outlook. One is the climate of opinion. The other is a hard economic reality.

Let us begin with the first. In spite of the Kennedy victory, the overall election evidence indicates that public opinion is actually more conservative now than it was two years ago. That half the electorate voted against Kennedy, in spite of Nixon's failure to speak out on major issues or to present his case effectively, shows how widespread the conservative feeling is.

Such a conclusion cannot, of course, be established beyond dispute. Sixty-nine million voters cast their votes for 69 million different mixtures of reasons. But an analysis supplied to me by Adm. Ben Moreell, chairman of the board of trustees of Americans for Constitutional Action, raises an impressive presumption.

The ACA has compiled an index by which it rates congressmen and senators according to their degrees of conservatism or radicalism. Their ratings are based on seven criteria: For sound money and against inflation; for economy and against waste; for the private market and against government interference; for local self-government and against centralization; for private ownership and against government ownership; for individual liberty and against coercion; and for national security. On this basis they found that with a few notable exceptions Republicans are far more conservative than Democrats. For example, in the House, those with ratings between 80 and 100 percent will include 91 Republicans and no Democrats; those with ratings between 0 and 9 percent will include 57 Democrats and no Republicans.

### ACA ANALYSIS

The election results showed that 24 New Deal Democrats with very low ACA ratings were defeated in the House by Republicans whose records indicate that they are far more conservative. Two conservative Republicans were defeated, a net gain of 22 for conservatism.

The unions threatened to purge everyone who voted for the Landrum-Griffin Act. Actual result: Of 229 members of the House who voted for passage, only four were defeated; of 201 who voted against passage, 22 were defeated.

Five New Deal Democratic governors—Loveless of Iowa, Freeman of Minnesota, Docking of Kansas, Furcolo of Massachusetts, and Herseth of South Dakota—were replaced by more conservative Republicans. The Republicans gained control of ten State Legislatures and lost two, a net gain of eight.

So much for the temper of the electorate. In addition, the effort to push through a huge paternalistic spending program will now find itself up against a hard (or should one call it soft?) economic reality: The loss of gold, the weakness of the dollar. ❁

## If We Demonetize Gold

January 16, 1961

It was in the early 1960s, writes the Chinese historian Hi-Ho-Hum,\* that the United States "demonetized" gold, with consequences that astonished the advocates of the plan.

In 1958, 1959, and 1960, continues Hi-Ho-Hum, the United States suffered a heavy loss of gold. The monetary authorities became worried. But an article in *The London Economist* of Dec. 24, 1960, suggested what seemed an easy way out of their difficulties. The article was in the form of a fable, set in an imaginary future. But its proposals were made in earnest, and so were its predictions of the economic consequences of adopting them.

What the article advocated, in short, was that the American Federal Reserve authorities put an embargo on gold, and discontinue either buying or selling it at \$35 an ounce or any other figure. The International Monetary Fund was to take over this obligation for six months longer, but announced that at the end of that time gold would be demonetized entirely. It would become "just a commodity."

### WHAT WENT WRONG

*The Economist* predicted that everybody would rush to get rid of his gold at \$35 an ounce while there was time; and that gold would finally fall to \$2.50 an ounce.

In disparaging gold (adds the historian in a footnote) the *Economist* talked as if it were being wonderfully clever and original. It forgot that sixteen years earlier, Keynes had denounced gold as "a barbarous relic"; that Bryan in 1896 railed against "crucifying mankind upon a cross of gold"; and that Sir Thomas

More, in 1516, suggested the proper use of gold was for prisoners' chains and chamber pots.

The American and IMF authorities, continues Hi-Ho-Hum, adopted the *Economist's* proposals with alacrity and even ecstasy. But the consequences, as we in 2072 now know, were the exact opposite of those the *Economist* had expected. No central banker, or private hoarder, was foolish enough to turn in his gold for 35 paper dollars an ounce. When the IMF tried to continue buying and selling gold at that figure, after the Federal Reserve Banks had stopped, it was drained of all its gold in three days. Gold, instead of falling in price, rose on the world's free markets to \$45 an ounce on the first day, soared to \$64 in a few weeks, and then settled between \$55 and \$60.

There was one regrettable side effect. Emergency psychiatric wards were opened in Washington and London hospitals to take care of monetary managers and *Economist* editors who had advocated the step and predicted that gold would fall to \$2.50 an ounce. They were suffering from shock.

#### HI-HO-HUM GOES ON

Yet a little thought, taken in time, might have saved them. They themselves had recommended that gold be treated just like any other commodity. The American Government took this literally. It ceased to make it a criminal offense to hold, own, or buy gold. Removing this prohibition enormously increased the demand for gold on the part of the people. Further, the gold was now being bought with, and priced in, paper dollars of unknown future value. People rightly interpreted the demonetization of gold as a mere first step to an acceleration of fiat money inflation everywhere. They sought to spend their paper dollars while the dollars still had any value.

Moreover, the "demonetization" of gold, paradoxically, led to resumption of its use as money, something not widely seen since 1914. New long-term contracts, debts, and bonds were made payable in ounces of gold, at the insistence of lenders who did not trust the future value of paper currency units. Exporters everywhere increasingly refused to sell except in terms of gold. Stores priced goods both in paper money and in grains of gold. Gold coins, privately minted and stamped with their weights, came into circulation.

After ten years, concludes Hi-Ho-Hum, the world's governments finally recognized that for the wrong reasons they had stumbled on the right thing. They were forced, in order to give them any value, to make their paper currencies convertible into gold again.

\*One of the most learned writers of the 21<sup>st</sup> century, frequently quoted by the late Simeon Strunsky. ❁

## A Needless Risk

January 23, 1961

Once more we have had an interregnum (of two and a half months) between the election of one President and the retirement of a predecessor of the opposite party. Once more needless risks were taken, uncertainty created, urgent decisions postponed, and serious harm done by the long delay in actual transfer of office and power.

The Communists did not miss their opportunity to exploit this interregnum. Castro launched on more seizures, charges, insults, and humiliations. When Mr. Eisenhower at last took the only step possible in breaking off relations, Mr. Kennedy disassociated himself from it on the excuse that he did not know the facts. There was even Democratic criticism of Mr. Eisenhower for "limiting the freedom of action" of the new Administration—though any decision or action whatever by the outgoing Administration in any field would necessarily do that.

Then Khrushchev sent a New Year's message, not to the legal President but to the President-elect, expressing hope that relations between the U.S. and Soviet Russia would "develop in the new year on a new and reasonable basis"—in other words, that we would make more retreats and concessions. Nothing was said in reply to disabuse him of this hope.

#### PREMATURE BUDGET

Communist aggression in Laos was greatly stepped up in tempo. In reply, the Eisenhower Administration could do little promptly or decisively because it had only a few weeks more in office.

By foolish law, and not by any constitutional requirement, Mr. Eisenhower had to deliver, within a few weeks of his leaving office, a new State of the Union Message, and a budget for a fiscal year that does not begin until next July 1—a year during which he will not be in office a single day and for which he cannot reasonably be expected to assume responsibility. It is improbable that Congress or the new Administration will pay the slightest attention to this budget. Its premature presentation not only puts needless work on the outgoing Administration but serves the mischievous purpose of seeming to relieve the incoming Administration of full fiscal responsibility for that year.

In Britain the budget for a new fiscal year does not have to be presented to Parliament until a few weeks after that fiscal year has already begun. Our budget law ought to be amended right now either to relieve an outgoing President of this senseless duty, or to change

the fiscal year, or to postpone the required date of the annual Budget Message.

### DANGER TO THE DOLLAR

But perhaps the most serious damage of the interregnum just ended has been in the monetary field. On Nov. 28 President Eisenhower served notice that he was “determined to take whatever decisions are necessary . . . to protect the integrity of the dollar.” From an Administration with only seven weeks to live, this pledge was practically meaningless. The attempt, wise or unwise, to negotiate with Germany on troop support was doomed to fail. What the world wanted to know was what the new President would do. But Mr. Kennedy was silent. He refused to repeat his pre-election pledge (of Oct. 30) not to “devalue the dollar from its present rate.”

His excuse for his silence and disassociation was substantially the same as Roosevelt’s to Hoover 28 years ago: “It would be unwise for me to accept an apparent joint responsibility with you when, as a matter of constitutional fact, I would be wholly lacking in an attendant authority.” Yet all during the interregnum period Mr. Kennedy was receiving and publishing “task force” reports recommending immense increased spending and deficit-creating measures. All these were undermining confidence in the dollar and increasing the run on gold.

The risks and evils of the interregnum period could be removed by a simple amendment of the Presidential Succession Act permitting any outgoing and incoming President to agree, if both wished it, to an earlier transfer of office and power than Jan. 20. This earlier date could be set in each case in accordance with circumstances and mutual convenience. Responsibility would then no longer be blurred, decisions no longer paralyzed. ❁

## A Crime to Own Gold

January 30, 1961

When this country went off gold in 1933 its bonds and currency contained the most solemn pledges that they would be redeemed in gold on demand, at their face value in dollars, at the rate of \$20.67 an ounce. This pledge was dishonored. Holders who asked for the gold they assumed was theirs were denounced as enemies of the country. They were ordered to turn over all their holdings of gold to the government. Further possession of the metal was made a criminal offense.

But in this act of bad faith there was one oversight. The government had neglected to make it a crime for American citizens to buy or own gold

*abroad.* Discovering this 28 years later, the Eisenhower Administration, though it had only one week to go, could not wait for the Kennedy Administration to assume office before plugging the awful loophole.

Let us pass over such trivial questions as the abridgment of personal liberty or private property rights. Will the new prohibition accomplish its ostensible aim of “protecting the integrity of the dollar” and halting or reducing the outflow of gold? Obviously it will do nothing to bring gold *back*. The amount of gold Americans hold abroad is not known. Estimates range from a top of \$1 billion to less than \$50 million—trivial sums against a world monetary gold stock of more than \$40 billion or even our shrunken holdings as of Jan. 11 (the lowest since 1939) of \$17.6 billion.

### FLOW-BACK UNLIKELY

But there is no reason to suppose that any substantial part of this American-held gold will flow back. Putting aside probable evasions of the new ruling, even the Americans who comply are unlikely to sell their foreign-held gold for dollars. They bought the gold precisely because they did not trust dollars. Therefore they will in all likelihood sell it for foreign currencies or investments—anything but dollars. Moreover, as they have until June 1 to sell, and cannot get less than \$35 an ounce for it, they may hold until then against possible dollar devaluation in the meantime.

True, the new regulation may prevent Americans from buying more gold abroad. But it will probably tempt foreigners to buy more gold at \$35 an ounce while they still have the chance. These foreigners, as pointed out by S.J. Rundt, a consultant on international business, include residents of Germany, Switzerland, Lebanon, Argentina, Belgium, Canada, Costa Rica, Ecuador, Jordan, Kuwait, Panama, Paraguay, Peru, Saudi Arabia, Uruguay, and Yemen. These people, unlike those in the Land of Liberty, are allowed to own, buy, or sell gold in any form.

### REDUCING CONFIDENCE

In brief, the Eisenhower Administration’s expiring act will further reduce confidence in the dollar. It will lead foreigners to conclude that our currency situation must be more desperate than they had supposed. Otherwise, why would a government with only one more week in office feel that action could not wait that long? They will also assume that this new prohibition is a prelude to further restrictions on the convertibility or transferability of the dollar, or on the movement of American capital.

The new prohibition attacks symptoms and neglects causes. It blames the “speculators.” It blames the people who have lost confidence in the dollar instead of



re-examining or correcting the policies that have caused them to lose confidence.

What the United States faces today is only derivatively a “balance of payments” crisis; it is primarily a crisis of inflation. If for a moment we neglect the goods and dollars that we deliberately give away in foreign aid, payments always balance—for the simple reason that people insist on being paid for what they sell. If, in return for the goods they sell to us, foreigners buy gold instead of other goods, it is because they think gold is the better bargain. They will think this as long as our commodity prices, as a result of domestic inflation, are too high as compared with the price at which we sell gold.

The real and only permanent cure for the gold outflow and the “deficit” in our balance of payments would be to halt our inflation. But this is the one course that nobody in office is seriously discussing. ❁

## What Is to Be Done?

February 6, 1961

President Kennedy’s assurance that “the dollar must be protected, the dollar can be protected in its present value” is gratifying as far as it goes, but will require courageous measures to make it effective.

The first thing we must do is to make the correct diagnosis of the disease. The prevailing diagnosis is not correct. What we are primarily suffering from is not a “balance of payments” crisis but an inflation crisis. Confidence in the dollar has not fallen because of a “deficit” in the balance of payments, but there is a “deficit” in the balance of payments because of our inflation. The cure, therefore, is not to try to tinker directly with the balance of payments but to *halt the inflation*. If we do this, the balance of payments will correct itself.

What would we have to do to halt the inflation?

1—We would have to raise short-term interest rates. Last June and August, the Federal Reserve did exactly the opposite of what was required when it lowered the discount rate from 4 to 3 percent. The direct effect was to cause short-term balances to go abroad for higher interest rates. The indirect effect was to cause loss of confidence in our determination to defend the dollar. We have encouraged monetary inflation to go on so uninterruptedly for 27 years that perhaps the only way we could convince the world we meant to halt inflation now would be temporarily to forbid any further increase in the total loans and investments of the banks.

2—We would have to balance the budget, convincingly and dramatically, not by another burdensome and

strangling increase in tax rates but by slashing nondefense expenditures—particularly such items as foreign aid, farm price supports, public roads and housing—and by halting further increases in welfare and social-security commitments. In brief, we must do exactly the opposite of what all the Kennedy task forces have recommended. It may be sobering to recall that of our enormous Eisenhower-planned budget expenditures of \$101.8 billion for the fiscal year 1962, \$54.4 billion, or more than half, are for nondefense items.

3—Finally, we would have to repeal all Federal labor legislation which compels men to join unions, compels employers to bargain exclusively with specified unions, permits mass picketing or labor violence—in other words, makes it next to impossible for employers to resist unreasonable, uneconomic, and inflationary wage demands.

Merely to list these essentials shows how tremendously difficult is the *political* problem of getting the only real economic solution accepted. The politicians wish to take precisely the opposite measures. The assumption behind all the task-force reports is that the correct solution of the dollar problem is more inflation, not less; that the way to cure unemployment is not to restrain or correct excessive wage rates but to increase government spending, to lower interest rates, to increase the supply of paper dollars still further, to raise prices—in short, to inflate and inflate.

### TRANSITIONAL STEP

In this unhealthy ideological climate, in which the real solution is so unlikely to be adopted (at least at present), one must face the question of the least harmful alternative. In fact, one must face the question of what must be done even if, after an inflation of 27 years, the real solution is now belatedly adopted. There are writers who believe that even today we could establish a full gold standard at \$35 an ounce. The result of any such attempt, however, would be to drain the Federal Reserve System of gold in a few weeks, and force an intolerable deflation.

Probably the least harmful transitional measure, pending re-establishment of a full international gold standard, would be for our government to stop buying or selling gold, permit a free gold market, and compensate foreign banks for any loss of value of their present dollar reserves in terms of their own currencies. Whatever drawbacks such a course may have, they seem less than those of the alternatives being seriously considered. The real danger foreshadowed by the Allan Sproul staff report is that we will plunge into still more inflation and attempt to “repress” its consequences by exchange controls and price controls. ❁



## Pledges vs. Policies

February 13, 1961

The President and his economic advisers seem to think that the integrity of the dollar can be defended chiefly by uttering the right phrases. So Mr. Kennedy “pledged” himself once more to take no action “to increase the dollar price of gold from \$35 an ounce” or “to impose exchange controls” or “to distort the value of the dollar in any fashion.” And then he proposed a gigantic spending program that would unbalance the budget, accelerate inflation, and precipitate a crisis that would lead either to a complete drain of our free gold reserves or the very exchange controls or rise in the dollar price of gold against which he was pledged. It is as if a debtor, whose current liabilities already exceeded his quick assets, were to pledge himself to repay on demand 100 cents on the dollar and then go off on a spending spree.

What ails the dollar today is not a “deficit” in the balance of payments or the loss of gold. This is merely a consequence of our past and future-feared inflation. The dollar can be saved only by abstaining from further inflation. Mr. Kennedy’s cure is to step up the inflation.

His remedy is the result of a wrong diagnosis. This is not merely his personal diagnosis. It is that of all his advisers—of the Galbraiths, Samuelsons, Sprouls, the authors of practically all his task-force reports. It is, in fact, simply the Keynesian diagnosis that has bewitched the New Dealers of the last quarter century.

### MORE INFLATION

To these people the greatest economic disaster that can befall a nation is unemployment. But it never for a moment crosses their minds that this unemployment may be the result of excessive wage rates or excessive labor costs that endanger or wipe out profit margins, that raise prices in the domestic market to a level that reduces demand, or costs to a level where we can no longer meet foreign competition. Never do their remedies for unemployment contemplate the slightest downward adjustment in any wage rate, no matter how out of line it may be. On the contrary, they insist on labor-relations laws and minimum-wage laws calculated to push money wage rates still higher.

And then they proposed to make these high wage rates payable by further inflation, which is to raise prices and “increase purchasing power.” This purchasing power is always to be increased by increased government spending, by bigger government deficits. And though they are always demanding “faster economic growth,” their concern for increased purchasing power or increased incentives for job-creating *investment*, for

enlargement or improvement of our productive plant, is at best secondary. Their primary demand is increased purchasing power for *consumption*. “The fairest and most effective step the Federal government can take to help fight the recession [the words are from the Samuelson report] would be to expand unemployment compensation benefits. Such expenditures go to those who need them and will spend the money promptly.”

### BUILT-IN UNSTABILIZER

So item No. 1 on the economic agenda is to increase and prolong these benefits—to “provide unemployment benefits of at least one-half of the employee’s earnings,” and to “extend the term of benefits to a minimum of 26 weeks in all states, supplemented by an additional thirteen weeks during periods of high national unemployment.”

But will bigger and longer unemployment benefits tend to reduce unemployment—or to increase and prolong it? May not this so-called “built-in stabilizer” be in fact a built-in unstabilizer? When we make bigger and longer payments to the unemployed we reduce the spur on the individual to seek a job promptly and the pressure on union leaders to accept more workable wage rates. We increase the rigidity of wage rates in the downward direction. In brief, we tend to increase and prolong unemployment as we increase and prolong the subsidies we pay for it.

Mr. Kennedy’s spending program will endanger the dollar still further. This is the most harmful thing he could do. It would not only undermine American prestige but disrupt international trade, confidence, and monetary stability. ☸

## Kennedean Economics

February 20, 1961

Mr. Kennedy’s economic program raises so many questions simultaneously that it seems best to discuss some of them in a series of brief notes.

**Campaign Document:** The President’s economic message of Feb. 2 is a partisan document. It professes to be dealing with a crisis brought on by the apathy of his predecessor. “In the past seven [i.e., Eisenhower] years, our rate of growth has slowed down disturbingly.” Slowed down from what? In the eight Eisenhower years our gross national product grew, in real terms, by 23.7 percent, or about 3 percent a year. Over the preceding eight Truman years it grew 8.1 percent, or 1 percent a year.

**The Growth Game:** The fact that the American economy reached the highest production on record in 1960, at \$503 billion, is treated not as an achievement but as a disgrace. This was nothing compared with what it *ought* to have done: “It was *capable* of producing at least \$535 billion.” If it had done what it ought, then “\$20 billion more personal income *could* have been earned. . . . Corporate profits *could* have been \$5 billion higher” and everyone *could* have had a job. The growth slogans may be economic hocus-pocus, but they are a wonderful political device. No matter what the economy has done, it can always be argued that it ought to have done better, and that your own remedies would have done it.

**Spending Cure-All:** Mr. Kennedy’s own chief remedy is spending, spending in every direction, more and faster spending on agriculture, on housing, on highways, on “urban renewal,” on unemployment compensation, on depressed areas, on distribution of “surplus” food, on school lunches, on veterans, on defense contracts, on education, on flood control, on irrigation, on forests, on “long-range energy resource development,” and on a beefed-up and expanded social-security program.

**No Budget at All:** How much would all this increased spending come to? Mr. Kennedy does not say. His message not only fails to give any total, but even the cost of the chief individual items. He is content to say that “the programs I am now proposing will not *by themselves* unbalance the budget which was earlier submitted”—apparently for the reason that he expects a deficit anyway, so what difference can a few more billion make? We are to operate, apparently, with no budget at all.

To be sure: “This Administration is pledged to a Federal revenue system that balances the budget over the years of the economic cycle—yielding surpluses for debt retirement in times of high employment that more than offset the deficits which accompany—and indeed help overcome—low levels of economic activity in poor years.” The political advantage of this system is that no one can ever hold you to account, because no one knows when an “economic cycle” has begun or ended, or just where we are in it, or when employment is ever high enough to take the terrible risk of balancing or overbalancing the budget. We have already had 24 budget deficits in the last 30 years. The record will become even worse if we adopt the indeterminate “cyclical-balance” theory as official doctrine.

**Social Security:** The most reckless spending proposal of all is that increasing social-security commitments in all directions. The OASDI program has long cried for expert reappraisal and study. Its “unfunded liabilities” have been estimated by actuaries as already from \$350

billion to \$650 billion. The month-long strikes, riots and violence in Belgium, when the government proposed very moderate reductions in the social-security benefits which some groups had got used to, were an ominous warning to other nations of the political as well as economic dangers of overcommitment. Social-security benefits are easy to raise, enormously difficult to reduce.

**Inflation:** In brief, the Kennedy economic program accepts lock, stock, and barrel the Keynesian economic philosophy, which never sees the cure for unemployment in any adjustment of wages, prices, or costs, but only in more and more spending and inflation. ❁

## Saving the Dollar

February 27, 1961

Once more, in his message to Congress on the balance of payments, the President pledged that: “The U.S. official dollar price of gold can and will be maintained at \$35 an ounce. Exchange controls over trade and investment will not be invoked. . . . A return to protectionism is not a solution.” Once more the actual policies he proposed would make it impossible to keep all these pledges.

Solutions must deal with causes. The “deficit” in our balance of payments is *not* the basic cause of our gold and dollar problem. The basic cause is inflation. This includes both the inflation that has been built up for the last quarter century and the future inflation that is now feared. The “deficit” in our balance of payments is itself one of the consequences of this inflation. Yet nine-tenths of the economic proposals that Mr. Kennedy has made in his first weeks of office would increase the inflation.

The assumption that the basic cause of our gold and dollar problem is the “deficit” in our balance of payments is a relic of seventeenth-century mercantilism. And most of the immediate measures that Mr. Kennedy proposed, seeking to eliminate this “deficit” directly, move in fact toward protectionism and exchange control.

### RESTRICTIONISM

This is true, for example, of his proposal to reduce the duty-free allowance for returning travelers from \$500 to \$100. This might have been urged on the ground that the larger allowance discriminates in favor of people who can afford to travel; but it was actually urged on a

“balance of payments” argument that would be just as good or bad for any other measure to restrict imports.

His other measures lead toward exchange controls and further restrictions on the freedom to trade and invest, to buy and sell, to lend and borrow. This applies to his endorsement of the prohibitions on Americans against buying or owning gold at home or abroad. It applies to his proposals for laws “to prevent the abuse of foreign ‘tax havens’ by American capital abroad as a means of tax avoidance”—leaving it to bureaucrats to decide just what is “legitimate” private investment abroad. It applies to his proposals to control and compartmentalize interest rates, discriminating in favor of foreign lenders, and keeping up short-term rates while pushing down long-term rates. Such schemes could not be made to work at all without exchange controls, government discrimination as between both borrowers and lenders, and detailed government intervention in the money market.

Finally, it is disturbing to have Mr. Kennedy decry as “speculation” every effort of Americans to protect themselves against further devaluation or debasement of the dollar. This view must lead to exchange control.

#### HALT THE INFLATION

Mr. Kennedy’s statistical pictures seems unduly optimistic. The fact is that against \$17.4 billion of gold reserves we have short-term liabilities to foreigners of \$20.9 billion. Nearly two-thirds of these are official holdings for which gold could be demanded; most of the rest could easily be turned into official holdings. Of our \$17.4 billion gold reserves less than \$6 billion are “free.” The remaining \$11.4 billion are held as a required 25 percent reserve against Federal Reserve notes and deposits. Mr. Kennedy hints that we could abolish the reserve requirement. This would merely protect foreigners a little longer at the permanent expense of our own citizens. One can imagine what the effect of such an announcement would have been if Americans as well as foreigners were free to convert their dollars into gold.

The first and only cure of the dollar problem, and the so-called balance-of-payments problem, is to *halt the inflation*. Nearly all of Mr. Kennedy’s proposals would increase the inflation. He is right in saying that “our costs and prices must be kept low.” But one does not keep them low by increasing the minimum wage. To pour more inflationary funds into the economy, and raise money-wages and prices, will only encourage and discourage exports still further, and increase the “deficit” in the balance of payments. We cannot cure the evils of inflation with more inflation. ⚙

## Jobs by Inflation?

March 6, 1961

We are in a recession. Unemployment is alarmingly high. We must *act*. “I hope we can get action as soon as possible.”

Thus the Kennedy Administration. And what is this action we must take so precipitously? It is more government spending in all directions—on unemployment compensation, crop price supports, housing, highways, depressed areas, veterans, social security, Federal aid to education, and scores of other projects. It is lowering interest rates and increasing loans. It is, in a word, inflation.

Behind this proposed remedy is the same theory that has dominated the economic policy of most Western governments, especially our own, for the last quarter century. It is the theory made popular by union propaganda and the late Lord Keynes.

Keynes himself recognized that raising wage rates would only increase unemployment. He left-handedly conceded that unemployment might exist because real wage rates were already too high in comparison with prices and demand, so that the outlook for profits was too bleak to encourage full employment. But he argued that a direct lowering of money wage rates would be so strongly resisted by the unions as to be politically impossible. Therefore the only way to lower wage rates to a workable level was to lower the value of money. The way to do this was to inflate, to print more money, and so to raise prices and monetary demand to a level at which full employment would be possible again.

#### WHY NOT FOREVER?

This is the process to which we have resorted again and again in the last 28 years. Economically, it has seemed to work. We have had continuous inflation, but we have also (at least since 1942) had fairly continuous employment. Politically, it has kept whatever Administration was in power from having to face up to the problem of how to halt constant union wage demands and increases that exceeded the gains in labor’s marginal productivity at the existing level of prices. We have floated ourselves out by ever new doses of inflation.

Well, why can’t we do it again? Why can’t we keep it up forever?

One reason it is especially dangerous to try it again now is that we have done it so much in the past that we have undermined international confidence in the dollar. Our labor costs of production on some items have been raised to a point that is pricing them out of the world market. American capital is being invested in new plants abroad rather than at home. Our existing



inflation has already caused a deficit in our balance of payments. We have been losing gold at a dangerous rate. Further inflation will only intensify the problem.

### DESPERATE RACE

And we can't keep inflating forever because the process inevitably becomes accelerative. With every dose of monetary inflation and increase of prices, the unions make demands for still further wage increases to keep up with or get ahead of the latest price increase. Each round of wage increases leads to another dose of inflation to pay the new wage level. There is a perpetual and increasingly desperate race between the printing press and the union demands.

Yet the whole race is needless. What is necessary for full employment is the coordination of wages and prices, at whatever average level. If this coordination does not exist, if a new dose of inflation simply touches off a new round of wage hikes, then the inflation is futile, even as a short-term expedient.

What labor is chiefly suffering from today is too many victories. It is no mere coincidence that unemployment now is highest in lines in which wage rates are highest. As compared with average wages of \$2.30 an hour in all manufacturing industries, wages in automobile plants are \$2.87 an hour, in steel mills \$3.02, in bituminous coal mines \$3.27. But in the excited calls of the Kennedy Administration for "action," there is complete silence regarding wage rates. They are treated as irrelevant.

Yet not quite. Among the proposed remedies for unemployment are higher and longer unemployment benefits and higher minimum wages to keep wage rates up or to force them still higher. ❁

## Protectionism

March 13, 1961

In his Feb. 6 message to Congress the President pledged that, "Exchange controls over trade and investment will not be invoked. . . . A return to protectionism is not a solution." Within a few weeks he not only approved the equivalent of exchange controls over trade and investment, but new protectionist measures.

On the exchange-control side, he not only endorsed the prohibitions on Americans' buying or owning gold at home or abroad, but he proposed discriminations against American and in favor of foreign lenders by offering the latter higher interest rates. He also proposed a scrutiny of American investment abroad to find

what part of it was "legitimate." All this foreshadows increasing government intervention and control of foreign lending and investment.

On the protectionist side, he has advocated a reduction from \$500 to \$100 of the amount of duty-free goods that American travelers can bring from abroad. This is made on the assumption that it will help the balance of trade by reducing imports. Then on Feb. 25 the President raised the tariff on foreign-made bicycles by 50 percent.

On the same day, the AFL-CIO, which is itself built on protectionist principles, but has hitherto given lip service to free trade, adopted a new formula which continued to pay lip service to free trade but, as one report summarized its conclusions, "with additional safeguards for domestic jobs and wage standards."

### FALSE ASSUMPTIONS

Individual unions announce their own protectionist policies. The Amalgamated Clothing Workers will boycott Japanese imports unless Japan puts a "voluntary" quota on shipments of men's suits. The Chicago local of the International Brotherhood of Electrical Workers will refuse to handle any Japanese-made electronic parts after May 1.

Behind all these protectionist measures, official and unofficial, there is not only the desire to protect special interests (at the expense of consumers), but false assumptions concerning the cause and cure of the dollar crisis. The outflow of gold and dollars is generally attributed to a "deficit" in the balance of payments. (It is, in fact, just another name for the same thing.) From this it seems an easy step to the assumption that if we cannot induce foreigners to buy more American goods, we can cure the "deficit" by penalizing Americans for buying foreign goods.

This is the protectionist theory. It goes back to the mercantilism of the seventeenth century. What it overlooks is the essentially two-sided nature of all trade. In the long run we can buy only as much as we sell, and sell only as much as we buy. To the extent that we refuse to buy foreign goods, we deprive foreigners of the dollars with which to buy our goods. When we buy their goods, and "lose" dollars, foreigners in the long run have no way of using these dollars except by buying American goods, services, or investments with them.

### GOLD AS A BARGAIN

It makes no difference how indirect these transactions are. If our troops spend dollars in Germany, the dollars do not disappear down a well. Even if the Germans use all the dollars to buy goods in Japan, the Japanese (or whoever) must eventually use the dollars to buy American goods. Trade (in the widest sense) must



balance. Payments (except for foreign-aid programs) must balance.

But suppose foreigners only want to use their dollars to buy our gold? Then the question we should ask is why they prefer gold (at \$35 an ounce) to other goods. They prefer it because it now seems a better bargain than other American goods. It is still at the same dollar price as it was 27 years ago, whereas other prices have more than doubled.

The first remedy is to halt the inflation that is pricing us out of the world market. But practically all Mr. Kennedy's "must" measures would increase the inflation. His protectionist schemes will have at best a temporary effect. They will be futile in the long run. And none of the measures that would go to the heart of the matter—to reduce spending, to cut foreign giveaway programs, to balance the budget, to restore monetary discipline—are even being considered. ☼

## Minimum-Wage Laws

March 20, 1961

The sponsors of minimum-wage legislation assume that they can force the payment of higher wages to marginal workers simply by commanding such wages to be paid. They assume that these higher wages will not force any of the workers affected into unemployment. If this were so, if a higher minimum wage did nothing but good, there would be no reason for stopping anywhere.

The advocates of new minimum-wage legislation ask: If \$1 or \$1.15 an hour minimum wage is good, why not \$1.25? But we may ask them in turn: If \$1.25 an hour, why not \$1.50? Or \$2? Or \$5? Or \$10 an hour? Apparently even the most naïve proponents of a higher minimum wage dimly recognize that there is *some* point at which an increase in the minimum wage could do more harm than good. What is this point? And how do they themselves determine where it is?

If we are to judge by the record, their standard is that the legal minimum wage should be always a little bit higher than the existing minimum, whatever that happens to be. In 1938, when the average hourly wage paid in all manufacturing was about 62 cents an hour, Congress set a legal minimum of only 25 cents. In 1945, when the average factory wage had risen to \$1.88 an hour, Congress [raised the] minimum to 40 cents. In 1949, when the average had risen to \$1.40, Congress raised the minimum again to 75 cents. In 1955, when the average had risen to \$1.88 an hour, Congress boosted the minimum to \$1. Now that the

average factory wage is about \$2.30 an hour, the proposal is to raise the minimum to \$1.15 in 1961 and to \$1.25 in 1963.

### ROAD TO INFLATION

Thus, as increased capital investment and new and better tools of production keep raising marginal labor productivity, and as the general level of wages is raised by competition of employers, the ideas of reformers as to what the minimum wage ought to be keep rising always a little ahead of actualities. Among the simple, this creates the optical illusion that it is the successive increases in the minimum-wage law that have pushed up the actual average of real wages. If that were really so, the most underdeveloped nation would have no problem. It could set wages wherever it wished, by passing a law.

No doubt minimum-wage laws have played a role in raising *money* wages. When unemployment has been brought about by higher minimum money wages (which tend to push up all other wages by persistence of existing differentials) increased political pressure has been built up for further monetary inflation to make the higher wages payable. Thus successive minimum-wage boosts have exercised continuous political pressure for more inflation.

### FORCING UNEMPLOYMENT

Minimum-wage laws tend to hurt most precisely the workers they are ostensibly meant to help. They increase unemployment especially among low-paid workers. For the first thing that happens when a law is passed that no one shall be paid less than \$1.25 an hour is that no one whose work is not deemed worth \$1.25 an hour will be employed at all. You cannot make a man worth a given wage by making it illegal for anyone to offer him less. You merely deprive him of the right to earn the amount that his ability permits him to earn.

President George Meany of the AFL-CIO has said: "If an enterprise cannot survive except by paying wages of 75 cents or \$1 an hour, I am perfectly willing for it to go out of business." This could be reworded as follows: "If workers are only getting \$1 an hour, I am perfectly willing to see them forced into total unemployment." How does this make them better off? Meany forgets that low as are the wages in the enterprise he is willing to destroy, the workers in those enterprises have presumably found them to be the best among the alternatives open; otherwise they would have taken jobs elsewhere. Workers are not benefited by being forced into unemployment or onto relief. Nor are the taxpayers. Nor are the former customers of the enterprises

forced to shut down. The nation is not benefited when its marginal production and industries are deliberately destroyed. ⚙

An International Money

March 27, 1961

Since West Germany revalued the mark on March 4, there has been a great deal of discussion concerning the probable effect of the change on its export and import trade, on its internal price level, and on the dollar. But one aspect of the change has attracted less attention than it deserves. The value of the mark was changed from 4.20 to the dollar to four to the dollar. In other words, the mark has been so revalued as to make it very simple mentally to translate one currency into the other. This is a step nearer to an international money.

Monetary reformers have long dreamed of a uniform international money. They have seen this as not merely a benefit to travelers but as a means of simplifying and facilitating all international trade, and comparisons of prices and statistics. This aim inspired the Latin Monetary Union in 1865, which embraced France, Belgium, Switzerland, Italy, and later Greece. While each country kept its own name for its currency unit, they established a one-to-one exchange ratio. Later Spain, Serbia, Bulgaria, and Rumania adopted the same currency unit. Sweden, Norway, and Denmark formed a monetary union of their own.

FRENCH PLAN OF 1872

In 1872 a French Imperial Commission proposed a scheme by which the leading world currencies would establish very simple ratios between each other and the franc:

	Then existing value	Proposed value
Franc	1	1
Florin (Austrian, silver)	2.47	2.5
Dollar (American, gold)	5.18	5
Pound sterling	25.22	25

Nothing came of the proposal. The first world war finally broke up both the Latin and Scandinavian monetary unions, because individual members resorted to inflation and exchange restrictions. But the breakup

called attention to something that had been taken for granted. Most of the world had been on a common gold standard. And on that standard it was far closer to an international currency system than it has ever come since.

Let us see just how the full gold standard unified the currency systems of the world. When the currency unit of nearly every major country was defined as a specified weight of gold (previous to 1934 the American dollar, for example, was defined as 23.22 grains of pure gold), every such currency unit bore a fixed relation to every other currency unit of the same kind. It was convertible at that fixed ratio, on demand, to any amount and by anybody who held it, into any other gold currency unit. The result was in effect an international currency system. Gold was the medium of exchange.

THE GOLD STANDARD

The international gold standard enforced strict monetary discipline within each country. When one country began to inflate, its domestic prices rose, its imports increased, its exports fell, its balance of trade or payments became “unfavorable,” its currency unit in the world’s exchange markets dropped “below the gold point.” Gold started to flow out. To stop or reverse the gold flow, it had to stop inflating, and to allow its interest rates to rise. The international gold standard coordinated prices, interest rates, markets, demand, supply, trade, and production all over the world. It did not “break down.” It was abandoned precisely because politicians wanted to get rid of the discipline it enforced against domestic inflation and internal tampering with money.

The great present need is to restore and perfect this system. We should never go back to a relationship of incommensurable values, typified when the pound at par was \$4.866,563. . . . This made calculations and conversions absurdly complicated. It often forced needless melting down of coins and recoinage. While other currency units should today be aligned with the dollar, we on our side should offer to set a new gold weight for the dollar in terms of the metric system—say a gram or a round number of decigrams. Then every country would be responsible for maintaining its own currency at par—without constant rescue operations by an International Monetary Fund—by maintaining confidence, by refraining from reckless budget deficits and inflationary credit expansion. This would be a true internationalism. ⚙

## Aid with What Strings?

April 3, 1961

Our foreign-aid program, now fourteen years old, is the product of sentimental confusions. Its basic assumptions are wrong politically, diplomatically, and above all economically. Yet just at the moment when our balance-of-payments crisis makes it most necessary to re-examine them, and to consider how we can most gracefully taper off the program, we are planning to expand it to "towering dimensions," and to commit ourselves for years ahead.

Consider the dimensions the program has already assumed. Since the end of World War II the United States has spent the staggering sum of \$90 billion in foreign aid—more than \$60.4 billion of it for economic aid—to more than 70 nations.

In a book written in 1947, I pointed out that inter-governmental loans (they were first proposed as loans, not gifts) were on the horns of a dilemma. "If on the one hand they are made without conditions, the funds are squandered and dissipated and fail to accomplish their purpose. . . . But if the lending government attempts to impose conditions, its attempt causes immediate resentment. It is called . . . 'American imperialism'; or 'interfering in the internal affairs of the borrowing nation.'"

### THE DILEMMA

This dilemma has never been acknowledged by the successive administrators of foreign aid. In practice, however, they have grabbed first one horn, then the other. Faced with waste, corruption, fantastically impracticable schemes, they tried to impose a few modest conditions. Faced with resentment of these conditions, they hastened to assure recipient governments that the aid would be given "without strings."

Now, in the new Kennedy foreign-aid program, particularly as outlined in the March 13 speech to Latin American diplomats, we are to impose conditions again. But unless I gravely misinterpret that speech, they are to be precisely the wrong conditions. We are to give aid, not if the recipients will adopt the only principle that can make the aid effective—the principles of capitalism, free markets, private property, private enterprise—but if they will adopt grandiose statist or socialist programs:

"Each Latin nation must formulate long-range plans for its own development—plans which establish targets and priorities." Was it by formulating long-range government plans and establishing governmental targets that the United States itself became the richest and most productive nation on earth? Or was it not,

rather, by permitting free *individuals* each to make his own long-range plan or establish his own targets and priorities?

### PRICE 'STABILIZATION'

Mr. Kennedy seems to call for more of the very programs that have brought many Latin American countries to their present distress. "The United States is ready to cooperate in serious case-by-case examinations of commodity market problems. Frequent violent changes in commodity prices seriously injure the economies of many Latin nations. . . . Together we must find practical methods of bringing an end to this pattern." It is precisely changes in prices that guide producers as to what to plant or make, and how much of it. It is precisely changes of prices in free markets that guide allocation of production among thousands of commodities, tending to optimum balanced production in the long run. It is precisely government attempts to "stabilize" such prices—Brazil's with coffee, ours with our own farm commodities—that lead to waste, imbalance, unsalable "surpluses," contrived scarcity, increased taxes, and final disillusion for the very producers being "aided."

It is true that the President makes some points in the other direction. He wants Latin American nations to "insure monetary stability." But it is precisely the "massive planning efforts" they have already made (of which he calls for more) that have led the great majority of them into appalling and inexcusable inflations. And our own present contemplated expansion and perpetuation of our foreign-aid program is one of the major threats to renewed inflation at home.

How long will it take us to learn that the most important thing we can do for world stability is to keep the dollar strong? ❁

## Handout or Investment

April 10, 1961

Near the beginning of his foreign-aid message to Congress of March 22, President Kennedy posed "a fundamental question: Is a foreign-aid program really necessary?" It is a question we ought to have asked ourselves a dozen years ago. Many of us will answer that continuance of a so-called *economic* (as opposed to military) aid program is not only unnecessary but harmful to the United States, and in the long run harmful to the recipient nations themselves.

The President's own answer to his question is that "there is no escaping . . . our moral obligations . . . our



economic obligations as the wealthiest people in a world of largely poor people.” But when did this obligation, historically, begin? When will we be able to consider it discharged? Has it any limits? What are they? Do we keep pouring out money until every country in the world is as rich as ourselves—or we as poor as the poorest? If we, by establishing a free economy, have made ourselves the richest nation in the world, shouldn’t we be proud of that achievement? Why should we have a guilt complex because others, with repressive systems, haven’t done as well?

The most specific sign of how the President measures the extent of our obligation is the proposal that each industrialized country provide annual aid to backward countries amounting to 1 percent of its gross national product. But this is a token figure, unrelated to the special “needs” of Chile or Chad. It may sound small, but it would mean more than \$5 billion a year for the United States. That is greater than the \$3.8 billion deficit in our balance of payments last year.

#### AID AND INFLATION

The President seems to take this problem lightly. He estimates that “not more than 20 percent of foreign economic-aid expenditures will affect our balance of payments” because 80 percent “will be spent directly” for our goods and services. But this overlooks that when we give away the dollars to buy part of our exports, we give away those exports. We cannot use the proceeds from those exports to buy our needed imports.

Our foreign-aid program, moreover, causes the budget deficit that causes the inflation that causes the deficit in the balance of payments. The President forecasts a budget deficit of \$2.2 billion for the fiscal year 1961 and of \$2.8 billion in 1962. But, other things unchanged, both deficits would be surpluses without the foreign-aid program.

Instead of “a series of one-year programs,” the President recommends “long-term development loans at low or no rates of interest” running for “as long as 50 years.” This proposal calls for careful scrutiny. Our own government is now paying more than 3½ percent a year for long-term borrowing at home. On every dollar borrowed now at that rate our taxpayers will have to pay \$4.58 at compound interest over 50 years. To charge no interest on such loans would be equivalent to giving away four-fifths of the amount even if the principal were repaid at the end of the period.

#### SOCIALIZED SOCIALISM

But the most serious aspect of the new foreign-aid proposals is that the money is to be given or lent only if the recipient countries promise to “engage in long-range planning,” to “mobilize their own resources,” to

set “targets,” to embark on “land reform” and “social justice.” This clearly means state planning. What we are offering to do is to subsidize other people’s socialism. We are insisting on more of the very planned economies that have brought a tangle of government controls and chronic inflations.

It is because this is what we have been doing in the past that the President is correct when he points out that “many of the nations we are helping are not much nearer sustained economic growth than they were when our aid operation began.” If we stopped our foreign economic-aid program these nations would have to turn to private investors. These investors would insist on the reforms really calculated to bring sustained economic growth. They would insist on assurances against seizures or stifling controls. The plan they would ask for is capitalism—the system of private property and *free markets*—to release the initiative and energies of millions of individuals everywhere. ❁

### Budgetary Chaos

April 17, 1961

The budget message that President Kennedy sent to Congress on March 25 was a baffling document. Here is both sample and summary: “This, then, is the revised budget—apart from defense additions—that I now present to the Congress: A budget that is *in balance* in terms of my pledge of Jan. 30. A budget that is *likely to be in deficit* unless economic conditions rapidly improve to meet the levels predicted in the Jan. 16 budget. A budget that *would be in surplus* if the economy were operating at or near its full potential.” How does one get a budget that is at the same time in balance, likely to be in deficit, and would be in surplus?

Mr. Kennedy’s pledge of Jan. 30 was that he would submit a program of expenditures that “will not of and *by themselves* unbalance the earlier [Eisenhower] budget.” He felt safe in making this pledge, it now becomes clear, because he expected a deficit even without new spending.

Mr. Eisenhower forecast a thin surplus of \$79 million at the end of this fiscal year and a substantial one of \$1.5 billion at the end of fiscal 1962. Whether or not he overestimated revenues and underestimated expenditures even on the basis of his own proposals, as Mr. Kennedy charges, Mr. Kennedy’s own proposals obviously add billions to the expenditure side of the budget. Hence his estimate that instead of a thin surplus there will be a \$2.2 billion deficit in the current fiscal year, and instead of \$1.5 billion a deficit of \$2.8 billion



in fiscal 1962. The expenditure estimate for fiscal 1962 is raised from Mr. Eisenhower's \$81.5 billion to \$84.3 billion. The increase in requests for new obligational authority is even more striking. Mr. Eisenhower recommended \$80.9 billion; Mr. Kennedy \$86 billion.

### **COST OF NON-DEFENSE**

"The point I wish to stress," says Mr. Kennedy, "is that any budgetary unbalance at the close of fiscal 1962 will not be the result of any nondefense programs I have submitted." This implies that it is defense spending that will cause a budgetary unbalance. Yet Mr. Kennedy's defense spending proposals for 1962 are only \$890 million higher than his predecessor's; his non-defense spending proposals are \$2.6 billion higher—almost equal to the total expected deficit.

Mr. Kennedy seems anxious to prove that whatever deficit occurs in 1962 will not be his fault. But in view of his own contention that a deficit in any one year isn't important anyway—that the only thing that counts is that the budget be "in balance over the years of the business cycle"—this anxiety is hard to understand.

### **IRRESPONSIBLE SYSTEM**

But the present budgetary chaos is not wholly the fault of Mr. Kennedy. It is even more the fault of our lack of any responsible budget system. "It is a legal absurdity [I quote my own *Newsweek* column for Jan. 26, 1953, on the Truman budget for fiscal 1954] that an outgoing President should be required to frame and present a budget for a year in which he will not be in office and for which he cannot and should not assume any responsibility." The result is mainly to obscure the fiscal responsibility of a new President for his first year and a half in office. This absurdity is imposed by the Budget and Accounting Act of 1921. That act should be drastically amended, now. Each President should be made unmistakably responsible for his full period in office.

This is a minimum reform, but it is far from enough. There can be no executive responsibility for the budget until the President, like the governors of 43 states, has the power to veto individual items in appropriation bills. Even this would not be enough to give us a truly responsible budget. In New York, the governor's annual budget must not only give estimated expenditures and revenues for the next fiscal year, but must be accompanied by bills containing all the proposed appropriations and any proposed new taxes. The legislature (I quote the state constitution) "may not alter an appropriation bill submitted by the governor except to strike out or reduce items therein." Here is a guide for the Federal system. Congress will not be a resolute watchman of the public purse as long as it is permitted to put its own hands into the purse. ❁

## **Inflation Without Jobs**

April 24, 1961

I have just received the English text of a speech delivered in Stockholm by the European economist L. Albert Hahn. It covers economic growth, saving, unemployment and inflation, and it applies with remarkable pertinency to our immediate problems.

On economic growth: "In every decade economists seem to be beset by some new panicky fear. In the '30s it was the fear of secular stagnation through oversaving and lack of investment opportunities. Nowadays it is the fear of insufficient growth. This fear develops sometimes into a desire to foster growth at almost any price, and leads, in fact, to real growth fanaticism. Most people, of course, favor the growth of the national product; but only few seem to realize that in order to achieve a bigger national product people have to work harder, and to save more; the latter in order to increase the worker's productivity by equipping him with more capital. The impression seems to prevail that an economy can, like Munchausen, pull itself by its own hair out of the mud of insufficient growth; in other words, that growth can be commanded at will. And the increase of the money supply is recommended as an appropriate means of such commanding. . . . [Yet] growth does not . . . depend on the amount of money in circulation, but on how much the people decide to work and save. It is, therefore, probable that the urge for growth will have inflationary effects."

### **BIGGER MONEY SUPPLY**

Defining inflation simply as an increase of money—bank notes plus demand deposits—Hahn points out that since 1939 the money supply in the U.S. has increased about fourfold while prices have about doubled. In the seven-year peacetime period from 1953 until today wholesale and consumer prices have risen by about 10 percent. What is alarming is not the extent of this depreciation, "but its happening during a period which included two recessions, 1953–54 and 1957–58. According to rule, prices should have declined again during the recessions; but they refused to do so. During the last of the two recessions they even continued to move up with the result that the next upswing started from an even higher price level."

Suppose, now, looking at our own statistical picture a little more closely than Hahn does, we try to see why prices continued to rise. For one thing, the money supply continued to rise. Between the end of 1953 and 1954 it went up \$3.7 billion; between the end of 1957 and 1958 it went up \$5.3 billion. If we include time deposits,

the increase in monetary media throughout the period has been uninterrupted and much larger.

### HOURLY WAGE RATES

Now let us look at average hourly wage rates. Since the end of 1953 they have risen from \$1.77 to \$2.32—not 10 percent, like prices, but 30 percent. It is particularly instructive to notice that they went up from \$2.29 in February 1960, to \$2.32 in February this year. This happened in a recession, when unemployment rose from 3.9 million to 5.7 million.

Classical economists would agree that the increased wage rates increased the unemployment. By raising wages sufficiently high one can create any amount of unemployment. This is because wage-rate increases are cost increases. They destroy the profitability of marginal enterprises and so reduce production. But under the sway of Keynesian doctrines, not only is it taboo to mention the wage level in connection with the extent of employment, but a discredited “purchasing power” theory creates political demands for boosting wage rates further. Hence the minimum-wage law agitation.

As nobody dares to suggest that our unemployment be corrected by a realistic wage-rate adjustment in the industries in which the main unemployment exists, Washington is seeking to cure it by another giant dose of spending and inflation, even though this must imperil the dollar.

And the economic and moral evils of that course (which I tried to point out myself last fall in a book called *What You Should Know about Inflation*) are explained with great cogency in an excellent little volume just published—*An Inflation Primer*, by Melchior Palyi (150 pages, Regnery, \$4). ❁

## Propaganda in Orbit

May 1, 1961

In spite of all the discrepancies in their story (see page 87), the Russians may finally prove that they shot a man into space on April 12 and brought him safely back. Yet we know that the Russian Communists lie on principle, and there was nothing in the crude propaganda with which they handled this case to remove any scientific doubts.

Gagarin's statement to the press told nothing about weightlessness or how the earth looks from high up that was not already familiar to the American magazine or newspaper reader or could not have been supplied by any hack science-fiction writer. If the scientific content of his statement was thin, the political propaganda was so thick that it read like a travesty: “I should

like to note especially that loving human care which is being shown in our Soviet Union toward the ordinary people from the Central Committee of the [Leninist Communist] party, the Soviet Government and our dear Nikita Sergeevich Khrushchev.” There was one piece of real news in the statement—“the first airplane” was invented by the Russians.

But suppose the Russians finally straighten out their discrepancies and prove that in this case, at least, they were telling the truth? With millions of human beings in Russia living six to a room in slums and hovels, and millions in slave camps, should we applaud the diversion of billions of dollars (as David Lawrence has asked) for a spectacular propaganda stunt that does nothing to advance the conditions of life? “A dictatorship,” as President Kennedy pointed out, “enjoys advantages in this kind of competition over a short period, by its ability to mobilize its resources for a specific purpose.”

### FIGURE JUGGLING

Hardly less remarkable than the Russians' propaganda about the flight was the instant and unquestioning acceptance of their claim by our own officials. We have made a habit of accepting all the Russian claims on the general principle that it is safer to overestimate the strength of one's enemy than to underestimate it. But we are in grave danger of downgrading our own system. We have long given credence to Russian economic statistics, for example, that even Khrushchev recently repudiated as “figure juggling.”

The eminent economist Colin Clark recently pointed out in testimony before a Senate subcommittee: “A statement which has now circulated so extensively that nobody ever questions it is the proposition that the real product of the Soviet Union is growing” at the rate of 6 percent per year . . . and that therefore it is mathematically inevitable that it must, within quite a few years, overtake and then surpass the real product of the United States. . . . Like so many other things which everybody knows, this supposed 6 percent per annum growth trend of the Soviet economy is an illusion.”

### RUSSIAN OUTPUT MYTH

Over the whole period 1913–56 Dr. Clark pointed out, the long period rate of growth in Russia averaged only 1.2 percent per year. Even if we reckon Russian productivity trends from 1928 or from 1939 we get figures of only 1.7 or 1.6 percent per year. The United States, on the other hand, Dr. Clark figures, has ever since the 1890s, subject only to minor fluctuations, maintained a steady rate of growth of real product per man-hour of 2.3 percent per year.

When we drop tricky projections of percentage rates of growth into the future and turn to actual present

achievement, there is no real comparison. Soviet farm efficiency, for example, is appallingly low. Russia uses one agricultural worker for every 10 sown acres, against one worker for every 60 sown acres in the United States. Crop failures and famines behind the Iron Curtain are recurrent, as illustrated today in Communist China.

The economic and other freedoms of the market economy—the capitalist system—are so precious for their own sake, that most of us would prefer it even if it were less productive materially than a Communist system. But it happens to be incomparably more productive. This is no accident. Private property, and the market system of rewards in proportion to marginal value produced, give incomparable incentives to production. ❁

## That 'Cyclical' Budget

May 8, 1961

In his Budget Message of March 24, President Kennedy took over a doctrine that has been preached for the last 30 years by spenders and Keynesian economists and declared it to be official policy:

“Federal revenues and expenditures—the Federal budget—should, apart from any threat to national security, be in balance over the years of the business cycle—running a deficit in years of recession when revenues decline and the economy needs the stimulus of additional expenditures—and running a surplus in years of prosperity.”

A “cyclical” budget of this sort would be, in fact, an abandonment of all fiscal responsibility.

No one can predict the business cycle in advance. No one knows just when an upturn will begin, how fast or how far it will go, when it will reach its peak, when it will crack, how far it will drop. There are, of course, hundreds of statisticians and forecasters, in and out of the government, who offer to tell us or sell us this information. Some of them will make better guesses than others. But in the nature of things, at any given time only a minority of them can be right. As the European economist L. Albert Hahn recently summed up the case: “If the business cycle were predictable, there would be no cycle, as everybody would hedge against it.”

### WHERE ARE WE?

No one even knows at any given time precisely where we are in a cycle. If we are in a recession, are we scraping bottom, or are we due to drop lower? If a recovery has started, will it peter out? Will it be mild? Will it be strong? If things are good, are we in a short-lived

boom? Or has the country taken off on a higher rate of longtime economic growth?

Economists may, in the main, agree that a past business cycle ran so-and-so-many months or years. A present or a future business cycle, however, has no pre-determinable length and no known end. Consequently, at no point can anyone charge that an Administration has definitely failed to balance the budget even over the cyclical period. The Administration in power can always argue that things are so unsatisfactory that a continuation or increase of huge spending or deficits is necessary. No matter how high an existing boom, the Administration will always be able to point to “pockets of unemployment” here and there, or to some groups that have not done as well as others. It will still argue that this is no time to endanger everything, and bring on unemployment and deflation, by overbalancing the budget and paying off debt.

### IRRESPONSIBLE PLAN

The cyclical budgeteers do not accept the logic of their own proposal. If, as they argue, it is unreasonable to expect a budget balance *every* year, because we cannot, say, foresee depressions and wars, then the corollary is that we should *normally* plan for a substantial annual *surplus*. If thumping deficits are necessary in the low years of the cycle, then equally thumping [surpluses] are required in the good years. But I have not heard any of those who advocated or helped bring on the \$12.4 billion deficit in 1959 demanding a \$12.4 billion surplus in 1962. They are urging or planning still more deficits.

So, to repeat, official adoption of the cyclical-budget doctrine would mean the complete abandonment of fiscal responsibility. No Administration could be held to account. It could always leave the balancing to its successors. *Après nous le déluge!*

Even without making it official, we have already had irresponsibility enough. We have had 25 budget deficits in the last 31 years.

The cyclical-budget doctrine, finally, not only promotes political irresponsibility; it is economically unsound. It got a massive tryout in the ten-year period 1931–40, and proved a massive failure. The average deficit in those ten years was 3.6 percent of the then gross national product (which would mean average annual deficits today of \$18 billion). The consequence was average unemployment of 18.6 percent of the working force.

Perpetual full employment is not assured by perpetual inflation. Full employment is the result of a proper coordination of wages, costs, and prices. But this is something the Keynesians have not yet learned. ❁



## The First 100 Days

May 15, 1961

At noon on April 29, President Kennedy completed his first 100 days in the White House. During the election campaign, he announced that these would be “the crucial days” of a new Administration, and drew a parallel with the famous first 100 days of Franklin Roosevelt’s Presidency.

In view of the hairline margin of his victory, Mr. Kennedy has so far been astonishingly successful in getting his domestic program through. Of the sixteen measures called for in his “must” list of February, seven have already been enacted, and some action is under way on all but two. The President can surely not be accused of inactivity. During the period he sent no fewer than nineteen messages to Congress—an unparalleled record.

But is this a record of “success”? That depends on what the practical effect of these measures will be (or will be judged to be) at the election three and a half years from now.

The President’s Cuban venture was a disastrous failure. It was seen to be such a failure by practically everybody within 72 hours after it was launched. The consequences of economic policies are more difficult to judge. Their long-run effects are often quite different from their immediate effects. The innumerable factors always at work in the economic realm lead to wide differences of interpretation. Bad consequences of bad policies are often blamed on something else—especially by those who originally recommended the policies. But the longer a bad policy is continued the worse its consequences tend to become, and the more obvious becomes the connection between the consequences and the policy.

### SPENDING PROGRAM

Let us now look at some of the major Kennedy measures, both enacted and proposed. They include a higher minimum wage with broader coverage; aid to depressed areas; higher and longer unemployment benefits; aid to dependent children of the unemployed; increased social-security benefits; with a lowering of the eligibility age; medical care for the aged; large Federal school aid; expanded foreign aid; an omnibus farm bill with higher price supports; lower interest rates through government intervention; withholding of taxes on dividends and interest (though with some limited incentives for business investment), and a “cyclical” rather than an annual balance—beginning with a planned deficit.

Space does not permit an analysis here of any one of these proposals. But they add up, individually and collectively, to a huge spending program. And all this is on top of the tremendous annual spending program in excess of \$100 billion (including social security) that had already been planned by President Eisenhower. This spending, and the deficits it would entail, are being taken very lightly. “Such a deficit [\$2 billion],” now says Secretary of the Treasury Dillon, “is not a cause for alarm in times like these. . . . Another deficit is in prospect for fiscal ‘62, one of about \$3 billion. This, too, will be entirely appropriate.”

### INFLATION AHEAD

What this spending and these deficits mount up to, however, is inflation. This inflation may seem at the beginning to be beneficent. The upturn in business that has already started may continue. In spite of the measures that discourage employment by forcing up labor costs, there may even be further improvement in employment.

But what will happen when all this inflationary tinder catches fire, as it eventually will? What will happen if world confidence in the dollar is shaken again? What will happen if the run on gold is suddenly resumed? What will happen, in brief, if the inflation, now so devoutly prayed for in the Administration in the belief that it will restore employment, not only arrives but starts to get out of hand? For as other governments have learned to their bitter cost, this is the way of “planned” inflations.

The Kennedy program, as unfolded in the first 100 days, is a program of inflation and welfare-statism. During the past two decades, the wrecks of such programs have been scattered over Europe and Latin America for all to see. The true friends of Mr. Kennedy will warn him of these consequences now, while there is still time to reconsider his course. ⚙

## Keep the Gold Reserve

May 22, 1961

If Congress, as the Administration now proposes, repeals the requirement for the Federal Reserve System to hold even a 25 percent gold reserve against its note and deposit liabilities, the United States will, in effect, drop the last vestige of a domestic gold standard.

The international gold standard, when it prevailed, was the chief safeguard against tampering with the currency on the part of politicians and bureaucrats. It was the chief safeguard against domestic inflation. It



did not “break down”; it was mismanaged and abandoned; and precisely because the politicians in most countries wanted to inflate. The result has been monetary chaos. In its May letter the First National City Bank of New York prints a table covering 43 countries. It shows that the dollar has been losing more than 2 percent of its purchasing power every year since 1950; the British pound, 4 percent; the currencies of Brazil, Argentina, Paraguay, Chile, and Bolivia, from 14 to 37 percent a year. Even the American depreciation rate would mean the loss of half the value of the currency in 33 years.

Every major step we have taken since 1932 has been away from the discipline of the gold standard. For 30 years the Federal Reserve Banks had been required to keep gold reserves of 40 percent against their notes and of 35 percent against their deposits. In June 1945 the Reserve authorities, fearing the continuation of World War II, asked that the legal reserve ratio be reduced as an “emergency” measure to only 25 percent for both notes and deposits. Though the war went on only a couple of months more, the higher reserve requirement was never restored.

#### **BLOW TO CONFIDENCE**

Meanwhile, we have continued to expand our credit and paper-money supply. Our total of demand and time deposits and currency outside of banks has increased from \$150 billion at the end of 1945 to \$250 billion. As its expiring act, the Eisenhower Administration prohibited Americans from buying or owning gold even abroad. And now the Kennedy Administration asks that even the legal requirement for a 25 percent gold reserve be abandoned.

Whether the first effect of such a measure would be to increase or undermine confidence in the dollar abroad, to reduce or intensify the foreign drain on our gold, we would learn very shortly. But its long-run effect could only be to undermine confidence in the dollar still further, both at home and abroad. Some Americans may fear that foreigners would drain us of gold, leaving us with no gold backing for our dollars at all. Even if such fears prove to be exaggerated, the last legal obstacle to an indefinite expansion of the Federal Reserve's note and deposit liabilities would be removed. Congress would be assumed to have given a green light to further inflation.

#### **HALT THE INFLATION**

Only under one condition would even a temporary suspension of the 25 percent gold-reserve requirement (already legally possible by simple vote of the Federal Reserve Board) be justified. This would be to accompany the suspension by the requirement that neither

Federal Reserve Banks nor member banks would be permitted to expand their total net loans or investments by a single dollar until the reserve ratio was restored.

Even this would not be too much assurance against further inflation. The present reserve ratio is 38 percent. This would still permit a substantial credit expansion under the present 25 percent legal minimum.

The abandonment of the 25 percent gold-reserve requirement, in brief, is the very opposite of what should now be done. What is required is a statement by the Kennedy Administration, accompanied by appropriate action, that our inflation can and will be halted. But every major economic measure that the Administration has so far supported moves toward more inflation.

We seem to have come to a point where the least-harmful immediate steps would be to put a temporary embargo on gold export, and permit a free market in gold. Later we could try to fix a sustainable value for the dollar and return to the discipline of a full gold standard. ❁

## **How to Cure Poverty**

May 29, 1961

The “real issue” in the Western Hemisphere, according to Secretary of State Dean Rusk, is the battle against poverty. Foreign aid, he keeps repeating, must be concerned with “social” as well as “economic” objectives; it must not perpetuate the gap between the rich and the poor.

Is the battle against poverty the “real” issue? Is it the problem with which Americans think their Secretary of State should be primarily charged? Or isn't that problem really the battle against Communist subversion and aggression?

The problem of poverty has existed from time immemorial. It is as old as man. Since the birth of capitalism—the Industrial Revolution—tremendous strides have been made toward its solution. But the problem of Communist subversion and aggression is peculiarly the problem of our time, our decade, of 1961. It is this that Americans are worried about. They are a generous people and would like to see other people better off. They have in fact done more in this direction than any other people in history. But the poverty in India, or the gap between the rich and the poor in Brazil, is not what keeps them awake nights.

Secretary Rusk seems to think that poverty is the primary cause of Communism, and that an increase in incomes would be the primary cure. Experience and statistics do not bear him out. In Italy and in a score of

other countries, Communism is nearly always found to be higher in the richer industrial districts than in the poorer agricultural sections. Communism has been growing while world income has been growing. The Broadway and Hollywood Communists also spoil the Secretary's thesis.

### NOT BY GIVEAWAY

One of the things we have been told for years by the advocates of foreign aid is that the world cannot exist half rich and half poor. It has in fact so existed for centuries. Of course poor nations do not buy much from us nor sell much to us. But neither do they threaten us militarily. It is nations well-off enough to embark on huge armament programs, like Nazi Germany, prewar Japan, and Communist Russia, that can do that. The latter can also subsidize aggression against us in the poorer countries.

Of course it is always desirable to reduce poverty, where and to the extent that we can. But what is the method or system most likely to do that? It is precisely here that Secretary Rusk and the advocates of bigger and longer-term foreign aid are most wrong in their implications. For they assume that the way to cure foreign poverty is by government-to-government giveaway programs, by state projects, state spending, state planning. In a word, by socialism.

### BRAZIL AND INDIA

This is made clear not only in their generalities but in their specific programs. A \$2 billion "international financial rescue package" is being prepared for Brazil, with smaller packages to bolster the economies of Venezuela and Bolivia. But the difficulties of these countries are of their own making. They are the result of their inflationism, socialism, Brasiliias and other grandiose state-planned projects. Now that they have run out of their own money, the U.S. is offering Latin American governments a \$600 million "social development fund" for more of the same. Our planners are also planning to lend India \$1 billion in the next two years to meet the foreign-exchange requirements of India's third Five-Year Plan, and to help India build a nuclear power plant and a government steel mill. India having borrowed and spent itself to the brink of bankruptcy, it is considered our duty to forget all about our own balance-of-payments problem and rush to the rescue of Indian socialism.

If the Kennedy Administration is right in thinking that foreign poverty is the "real" problem, it has chosen precisely the wrong way to solve it. The problem of poverty cannot be solved by Communism, socialism, or state planning, but by capitalism—by the system of freedom of private property, private enterprise, and

free markets. But few of our officials, despite occasional lip service, seem to have any real faith in the system that has made it possible for us to keep bailing out the socialist failures. ⚙

## Gold and the Dollar

June 5, 1961

The Kennedy Administration's proposal to eliminate the gold-reserve requirements for Federal Reserve Banks is extremely ill-advised and dangerous. It is fortunate that the opposition to it was so extensive as to cause Congress to postpone the scheduled hearings. We should utilize the breathing space to consider not only the objections to such a drastic measure but what positive steps we need to take in monetary reform.

The most important step is to halt the inflation. It is the almost uninterrupted inflation of the last quarter century that has created the whole gold and dollar problem. The inflation has been the primary cause of the "deficit" in our balance of payments. It has been the primary cause of our loss of gold, and of the threat of further loss. It is the inflation that has undermined confidence in the dollar. It is the inflation that has raised our prices and wages to a point where we are having increasing difficulty in competing in the world market.

To halt the inflation it is simply necessary to stop expanding the supply of money and credit. We must balance the budget. We must end the folly of foreign economic aid. We must cut Federal nondefense expenditures on scores of projects. We must stop all Federal Reserve or government efforts to push down interest rates. We may even have to freeze the total of bank loans and investments till we are sure the inflation is halted.

### INFLATION VS. FIXITY

But the Administration today does not dream of taking even the mildest of these measures. It looks upon an unbalanced budget with complete complacency. It is expanding all the old spending programs and proposing scores of new ones. It is increasing the pace of inflation, and daily intensifying the very dollar problem it is trying to solve.

But—and this is the sad situation at which we have arrived—even if the Administration took every requisite measure to halt the inflation, it could not solve the immediate problem that confronts us. That problem is the result of 27 years of inflation *combined* with the maintenance of a fixed exchange rate for the dollar

and the commitment to sell gold at \$35 an ounce to any amount asked for by foreign central banks.

Our gold base has become too narrow in comparison with the vastly increased amount of notes and deposits created against it. Since 1934 our average domestic price level has more than doubled, but an ounce of gold can be obtained for the same price. Our increased money supply and price level encourages imports, discourages exports, and makes our gold the biggest price bargain the U.S. offers the rest of the world. If we keep our \$35 an ounce price, and allow foreigners to draw out as much gold as they want at that price, we stand to lose our entire gold supply. The only alternative would be a deflation so drastic that our people would find it intolerable.

### IS \$35 TENABLE?

This is what those who think we could keep gold convertibility at the present price, and even extend it to American citizens, fail to see. They refuse to face the fact that our inflation has already gone too far to make the \$35 an ounce price any longer tenable—unless, of course, we turn the ostensible “convertibility” of our dollar into a meaningless fiction.

The least harmful thing we could do, therefore (reluctant as one is to make the suggestion), would be to put a temporary embargo on gold export. The next step would be to legalize a free exchange market and a free gold market. Special arrangements could be made to protect foreign central banks against loss (in terms of their own currencies) on their existing dollar claims on us. Then we could try to set a new gold value for the dollar that would be neither inflationary nor deflationary, and return to a full gold standard, with convertibility for Americans as well as foreigners.

Whatever objections there may be to such a course, it is infinitely preferable to any of the alternatives now being proposed, such as trying to maintain the present mock gold standard at \$35 an ounce, or plunging into a new worldwide inflation through the Triffin plan or a money-printing IMF, or abandoning our own gold-reserve requirement. ☸

## Reaching for the Moon

June 12, 1961

The May 25 message of President Kennedy to Congress is a profoundly disheartening document. At a time when total planned Federal expenditures (including social security) are already in excess of \$100 billion a year, when we are already anticipating serious deficits,

when taxes on enterprise and investment are already so burdensome that they are reducing incentives and employment and slowing down economic growth, and when we have already piled up enough inflationary tinder to threaten a grave new inflation, Mr. Kennedy calls for bigger spending, bigger deficits, and more burdensome tax rates. His latest proposals increase the inflationary threat still further.

Since he came into office, Mr. Kennedy has put in requests for over \$6.5 billion additional spending for the current fiscal year and the fiscal year to end June 30, 1962. A small part of this addition is for defense. But most of it is for new or expanded “welfare” programs, including increased foreign economic aid, increased social-security benefits, medical care for the aged, Federal aid to education, housing, and urban renewal, increased funds to farmers, to veterans, to unemployed workers.

### EXPENSIVE STUNT

And now, on top of all, the President asks us to spend \$7 billion to \$9 billion over the next five years, and perhaps \$40 billion over the next ten years, to land a man on the moon and get him back.

Why? So far as the scientific value is concerned, Dr. Vannevar Bush, head of the Office of Research and Development during World War II, some time ago characterized the man-in-space program as “a vastly over-rated stunt. . . . There is nothing a man can do in space that can’t be done better and more cheaply by instruments. Suppose it cost \$1 billion to put a man on the moon. For the same money you could support 1,000 research projects for 40 years. We need more basic research in physics, chemistry, and biology. We need to finish the job of handling arthritis. We need to know more about the genetics of viruses. I believe we can spend money to better advantage on earth than by shooting it into space.”

If the scientific value of this stunt is minimal, compared with the cost and with the potentialities of alternative projects, what other purpose would justify it? Propaganda? Instead of trying to outdo the Russians with Buck Rogers marvels, it would be enormously cheaper and more effective to make more propaganda use than we have so far dreamed of making of the freedom and productivity achieved under our private-enterprise system—a freedom and all-around productivity with which no socialist or Communist system can compete at all.

### SACRIFICE—FOR WHAT?

The President speaks of the need of making sacrifices. But sacrifices for the mere sake of sacrifice don’t make sense. We must sometimes give up what is good today to achieve a greater good tomorrow. Mr. Kennedy is



asking us to sacrifice what is good to achieve something of much more questionable value. Monetary stability, the welfare of consumers, the incentive to earn more and produce more, are not minor goods. Before we give them up, we should take a hard look at what we are offered instead.

And we cannot get a quart out of a pint jug. Whatever resources are devoted to new purposes and new projects must be withdrawn from old purposes and old projects. There is no economic fourth dimension. Mr. Kennedy sometimes talks as if there were, and as if it were created by government spending. But whatever the government spends on new programs it must either take from old programs or take from Americans in increased taxes. This means that alleged new needs can be met more adequately only if old needs are met less adequately.

True economy means wisdom in spending. It means saving on what is less necessary or less urgent in order to devote limited resources to what is more necessary or more urgent. It means putting first things first, establishing priorities. When the American people are urged to make sacrifices in their living standards in order to shoot a man to the moon, it is time to ask what has happened to our national sense of proportion. ❁

## The Dollar Problem

June 19, 1961

In the issue of June 5, I suggested that the least harmful solution of the dollar problem today would be to put a temporary embargo on gold export, to legalize a free exchange market and a free gold market, to guarantee foreign central banks against any long-run loss (in terms of their own currencies) on their existing dollar claims against us, and then, after setting a new gold value for the dollar that would be neither inflationary nor deflationary, to return to a full gold standard.

Whatever objections there may be to such a course, it is infinitely preferable to the alternatives. Four main courses are now being advocated by various groups: (1) The Administration plan to abandon our whole legal gold reserve requirement. (2) The proposal to keep our gold reserve requirement, and to make the dollar convertible at \$35 an ounce, not only by foreign central banks, but by American citizens. (3) Devaluation of the dollar, with the retention of the present International Monetary Fund system. (4) The Triffin plan or some similar proposal to turn the IMF into a world central

bank with power to create "reserves" (i.e., more paper money) for national central banks.

### RESERVES AS A BRAKE

Every one of these courses is inadvisable and dangerous. But the Administration plan to abandon the legal gold reserve would do the quickest irreparable harm. I discussed this in *Newsweek* of May 22. Here I will content myself with an excerpt from the vigorous analysis by Prof. Walter E. Spahr of the Economists' National Committee on Economic Policy:

"The common experience of nations with central banks lacking the protective device of reserve controls has been overexpansion of nongold money and credit, decline in the purchasing power of the currencies, and repeated devaluations. . . . Bank reserves are needed . . . to place restraints on the extension of notes and deposits. . . . Under present reserve requirements, the braking mechanism is in the form of a normal minimum requirement of 25 percent and a progressive tax on deficiencies below that percentage. . . . Without this protective device, foreign holders of nongold dollars could take all our reserves, and without penalty, leaving our money and banking system a hollow shell of irredeemable paper money the value of which could fall, quickly or slowly, to any depth. Our people and nation could be ruined as a consequence."

### FREE-MARKETIZATION

Unfortunately, however, our inflation, our increase in notes and deposits, and the increase in our price and wage level have all gone so far since 1934 or even since 1945 that it will soon no longer be possible to maintain real gold convertibility of the dollar at \$35 an ounce, even for foreign central banks, let alone for American citizens. If we tried such a thing, the Federal Reserve System would quickly be drained of all its gold or we would have to impose a drastic deflation to prevent it. Either consequence would be intolerable. Those of us who have been fighting inflation for twenty years must be realistic enough to recognize that it has now gone too far to make real redemption at a rate of \$35 an ounce any longer possible.

This does not mean, however, that it would be necessary or wise to devalue the dollar at some arbitrary rate (say at \$70 an ounce) and go on with the present IMF mock-gold system. The rate so fixed might be inflationary. A new inflation would probably take off again from that point. The proposal for a "free-marketization" of gold, with the purpose of getting back eventually to a full gold standard, should not be confused with a new dollar devaluation.

The greatest danger at present, apart from the abandonment of our legal gold reserve, is the adoption of



the Triffin plan or its equivalent. British publicists are pushing hard for this plan. Its appeal is that it looks like a simple and easy way of increasing world “reserves” (of IMF paper money) so that the bureaucrats of all countries could go right on with their inflation. If its sponsors could succeed in putting over such a plan, the gold standard would become the merest fiction, and the world would be launched on an inflationary binge without visible end. ☸

## Day of Disillusion

June 26, 1961

When the foreign-aid program was first proposed by Secretary Marshall in 1947, its chief declared purpose was to repair the ravages of war in Europe and to promote a swift recovery. Later, the declared purpose was to raise living standards in the recipient countries. Later, a chief declared purpose was to halt the spread of Communism. Another announced purpose was to win allies or at least friends for the U.S. Another was to raise U.S. prestige. Another was to promote stable democratic government in the countries aided.

In the light of the fourteen-year record, these announced purposes now seem ironic. True, the European countries originally aided have recovered from the ravages of war. But history shows that countries always recover with surprising rapidity from the ravages of war. And the countries that we aided least, like Germany and Japan, made far more rapid recoveries than countries that we aided most. As for living standards, the only way to raise them is through increased formation of capital, seldom encouraged by governments of underdeveloped countries.

Communism has spread to an appalling extent since the foreign-aid program was launched. We have lost friends every year. Our prestige abroad has been falling at an accelerative rate. We have been powerless to promote stable democratic government even where our aid and intervention have been greatest. To recall what the foreign-aid program has *not* accomplished, it is enough to mention Laos, Cuba, Korea.

### HARM UNFORESEEN

But the foreign-aid program has brought results that its sponsors failed to foresee. Even before the program started to promote socialism abroad by direct encouragement, as in India, it made its continuation possible by subsidizing governments that carried on socialistic projects. It has systematically bred unfriendliness to the United States. Every little “strong man” who receives

aid from us is forced to show his own people, by snubbing or denouncing us, that he is not giving up his independence or the national pride in return for our aid. Since the end of World War II our foreign aid of all sorts has reached the fantastic total of \$90 billion. A simple statistical comparison shows that it has been responsible for our whole net budget deficit since the program was launched, for the whole net increase in our national debt since then, and for an increased tax burden besides. It has been the chief fiscal cause of the inflation, of the unfavorable balance of payments, and of our loss of gold.

Yet the Kennedy Administration not only wishes to increase foreign aid substantially, but to avoid the necessity for annual Congressional approval by authority to borrow \$7.3 billion for it over the next five years.

### FOREIGN AID IN TROUBLE

In *The New York Times*, Cabell Phillips reports growing signs that the economic-aid program of nearly \$3 billion for this year “will encounter greater difficulties with Congress than aid programs have met in many years.” He attributes this largely to “articulate and well-organized . . . lobbies working against the bill.” The only lobby he finds room to discuss is the Citizens Foreign Aid Committee, headed by Walter Harnischfeger, Brig. Gen. Bonner Fellers, and Clarence E. Manion, which consists of only 44 members and operates on a budget of around \$50,000 a year. “There is not, on the other side,” declares Phillips, “a comparable lobby with the same singleness of purpose or the same resources to propagandize at the grass roots.” This statement astonishingly overlooks the government foreign-aid agencies themselves, with their thousands of employees and millions of the taxpayers’ own money to propagandize the full year round for the continuation and expansion of their activities and funds.

If a tiny organization like the Citizens Foreign Aid Committee, with a Multigraph machine, can have real success in bucking this full-time bureaucratic lobby, it must be incredibly “articulate and well-organized.” Yet with all due admiration, its success may, perhaps, be attributed to an additional factor. It may just be that congressmen recognize that what the committee is saying is true. ☸

## Mock Gold Standard

July 3, 1961

How does it come about that not only the present Administration, but some of our private bankers, now

think it would solve our monetary problems to abolish any legal requirement to hold a gold reserve?

For a full answer we need to go back to the origin of banking and of fractional reserves. The original goldsmiths, or banks, kept gold for safe-keeping and loaned it out at interest. But depositors or borrowers seldom drew out the entire amount to which they were entitled. They merely signed drafts or checks ordering the bank to pay over specific amounts to third parties. These third parties in turn were often content to leave their gold on deposit and draw checks only as they needed to make payments.

Thus bank deposits subject to check came into being. And the volume of this bank-deposit money was much greater than the gold “base” into which it was all nominally convertible on demand. The system worked as long as everybody accepted the deposit credits as being “as good as gold” itself. The system, in brief, rested on confidence—confidence that it would never be abused, and that individual banks would be at all times not only solvent but liquid.

#### **INVERTED PYRAMID**

Then governments stepped in, and based national currency systems on the fractional reserve principle. They developed further “economies” in the use of gold. In other words, they developed a system by which a still bigger inverted pyramid of bank notes and bank credit could be based on the available supply of gold. This was the central bank. The central bank was authorized to issue its own bank notes (which were made legal tender) against its gold stock. It could “centralize reserves” by ordering “member” banks to leave gold or cash reserves permanently on deposit with it. It could make loans to these member banks which they, in turn, could count as “reserves” against which they could issue still more deposit money.

In the United States, in 1932 and 1933, the confidence of holders of Federal Reserve notes that they would be able to convert into gold at any time they wanted collapsed. They rushed to convert. Their distrust proved justified. Gold redemption was suspended. The government did not blame its own monetary policies. It denounced the people who had lost confidence and had demanded gold. It devalued the dollar, thus breaking faith with everybody who had relied on its most solemn pledge. It not only terminated the right of its own citizens to demand gold for their notes; it made it a crime for them to buy or own gold no matter where they got or held it.

#### **WATER IN THE MILK**

But the government wanted to maintain the new parity for the dollar in terms of other currencies, so it

allowed foreign governments and central banks, and them alone, to demand gold. Our official monetary authorities found that by following this restricted convertibility they could build up a still bigger inverted pyramid of credit on their existing gold supply. But now that they have built the inverted pyramid and the wage-price level so high that even foreign central banks have begun to lose confidence, the Administration and a few bankers now ask: Why have any gold reserve at all? Isn't the whole thing an economic waste, an outworn superstition, a “barbaric relic”? Why can't we leave it to “able and responsible men” to regulate our money supply, which will consist purely of engraved slips of paper?

What this demonstrates is that once you begin diluting the money supply, the pressure grows for more and more dilution. The milkman who has been caught watering the milk then tries to convince his customers that they are better off with plain water. As the connection between the gold basis and the currency outstanding against it becomes increasingly remote, tenuous, and purely symbolic if not fictional, people begin to ask why it cannot be abolished altogether. The answer is that when the unit of money represents no real tangible value, but a scrap of paper whose supply is determined by the mere discretion or caprice of the politicians in power, history shows that the inevitable end result is monetary instability and uncontrolled inflation. ❁

## **Labor Law Gone Wrong**

July 10, 1961

A quarter of a century ago, in the first Franklin Roosevelt Administration, Federal labor law took a wrong turn. It was based on the theory that the chief reason there were strikes and labor dissensions was that unions were too weak and lacked “bargaining power.” The Wagner Act in effect put the government into the union-organizing business. It made it compulsory for employers to recognize any union, certified by a government board as comprising a majority of the employees of an “appropriate” group, as the exclusive bargaining agent for all employees in that group. A company was forced to “bargain collectively” with the representatives of this group—and with no one else.

The act thus rested on a legal principle never countenanced in any other field. While it was cloaked with the phrase “free collective bargaining,” it was in fact a denial of the freedom to bargain. It took away from the employer the right to choose the persons with whom he bargained. It took away from any individual worker

the right to bargain for himself, and from any minority union the right to bargain for its own members.

### RESORT TO VIOLENCE

If the same principle were extended, a company management could be compelled to “recognize” and to “bargain with” only one particular supplier of raw materials. No matter how bad the material offered, no matter how unreasonable the price asked, no matter if the supplier insulted and denounced him, he would have to continue “negotiating” and “bargaining with” that supplier. He could not simply break off and ask for competitive bids from other suppliers, lest he be haled before a Federal board and condemned and penalized for an “unfair practice.”

But the legal situation of labor-management relations is much worse than this. For the unions enjoy *de facto* the right to throw mass picket lines around any plant or in front of any dock or ship and intimidate any other workers from applying for the jobs the strikers have deserted. Worse than this, they can often with impunity resort to flagrant vandalism and physical violence. Those interested in typical details should read *The Kohler Strike* by Sylvester Petro.

Yet for 25 years no one in power has seriously re-examined the premises of the Wagner Act. The Taft-Hartley Act amended the Wagner Act in minor respects, but it kept its principal compulsions on the employer and its principal immunities for labor unions. The Norris-LaGuardia Act, since 1932, has in effect denied the employer injunctive relief from intimidation and violence. The Supreme Court, with its doctrine of “preemption,” has further discouraged action by the local authorities to prevent strike violence. And each time a new nationwide strike has broken out, paralyzing essential production or transport, the Administration in power has talked and acted as if there were perfect freedom of bargaining on both sides and no intimidation at work.

### ONE-SIDED DURESS

In the maritime strike, Secretary Goldberg, ignoring the picketing and violence at the piers and oil refineries, requested all parties to “talk,” to “resume direct negotiations”—just as if one party, the employers, were not in effect acting under duress. He has declared that the Taft-Hartley Act does not give the President “a sufficient arsenal of weapons to deal with a problem of this character.”

Someone, I hope, will at last suggest that the trouble is the opposite of this—that the Federal government has intervened too much in labor disputes, and in the

wrong way; that if the employer had the clearly recognized legal right to discharge strikers and to replace them; if intimidatory mass picketing were forbidden, and the laws against violence enforced; if the freedom to bargain were restored to the employer and to the individual worker, there would be an astonishing drop in the number of irresponsible strikes called, and unions would greatly moderate the unreasonable demands that present labor law now encourages them to make. The government would not have to ask for dubious 80-day Taft-Hartley strike injunctions, which politicalize every strike settlement, and must finally lead to the desperate expedient of compulsory arbitration. ❁

## Could Credit Collapse?

July 17, 1961

At the end of June there was a minor “gold rush” in Europe. Some dispatches attributed the increase in demand for gold to a series of articles published in British and Continental newspapers by Jacques Rueff, the French economist and financier. Rueff argued that unless the present international monetary system was changed, the world was heading for another crash of the proportions of that of 1929.

He has also put this argument forward in the July issue of *Fortune*. A great peril, he contends, hangs over the economy of the West. “The instability in our monetary system is such that a minor international incident or . . . disturbance could set off a worldwide disaster.” The measures suggested for dealing with this peril fail to go to the roots of what is wrong. “The nature of the disease is apparent in this fact: During the decade 1951–60, while the U.S. was piling up balance-of-payments deficits totaling \$18.1 billion, some \$13 billion accumulated in foreign hands in the form of sight deposits or short-term investments in the United States money markets. This \$13 billion constitutes a claim on the U.S. gold reserve that could be called at any time—with catastrophic consequences.”

### A ‘PRODIGIOUS ERROR’

“This came about because, in the countries that were creditors to the U.S., the central banks were content to accept dollars in settlement instead of demanding payment in gold. . . . Paradoxically, the danger we are in was brought about not because the U.S. lost gold, but because it lost *so little* gold. During the decade U.S. gold reserves fell by only \$5.3 billion. If the U.S. had settled its balance-of-payments deficits entirely in gold,



its reserves would have dropped—all other things being equal—by \$18.1 billion, and today they would amount to a mere \$4.7 billion. By all the evidence, such an unthinkable drop in reserves would not have been tolerated. Action would have been taken much earlier to stop the deficits.”

Rueff concludes that “the American balance-of-payments deficits were allowed to persist for the last ten years only because the U.S. was not really required to settle its debts abroad.” This situation “is the product of a prodigious collective error.”

This error, in Rueff’s opinion, was the passage at the International Economic Conference in Genoa, back in 1922 (eleven years before the U.S. went off the gold standard), of Resolution 9, which recommended adoption of an international convention embodying “some means of economizing the use of gold by maintaining reserves in the form of foreign balances.” This brought into existence the “gold *exchange* standard,” under which central banks consider themselves authorized to create money not only against gold or government bonds, but also against any foreign currency considered as good as gold.

### CREDIT PYRAMID

Under this system, the U.S. has enjoyed a “deficit without tears.” Foreign countries could leave their dollars on deposit with us, thus enabling us to continue building credit on them, while they built their own inverted pyramid of credit on them. It is this “double pyramid of credit” that is in danger of toppling.

What is the remedy? Rueff rightly points out that it is certainly not the Triffin plan, which would give the International Monetary Fund the power to issue its own international money and increase the world inflation. He quite properly insists, also, that we must eventually “liquidate the unstable and dangerously vulnerable situation resulting from the duplication of the credit structure, built on the gold reserves of those currencies with key currencies.”

It is when he gets to this point that Rueff’s otherwise brilliant discussion becomes unsatisfactory. He is right when he insists that we must halt both the U.S. and the world inflation. But we cannot tolerate an American or a world *deflation* either. This would almost certainly be the consequence of any attempt, however gradual, to “pay off in gold [presumably at \$35 an ounce] all the dollar assets held by central banks outside the U.S.” First of all (preferably through a transitional free market in gold) we must get back to a tenable gold rate for today’s depreciated dollar. ❁

## A ‘Dual Economy’?

July 24, 1961

If you want a quick reputation as a brilliant economist, the formula is simple. Just put forward “new” reasons for still more government intervention, more government spending, and more inflation.

This was the secret of the enormous success of Lord Keynes. The theories of J.K. Galbraith have superseded those of Keynes because where Keynes advocated more government spending and controls only periodically, to combat mass unemployment, Galbraith advocates them as permanent and uninterrupted policies.

Galbraith wants to siphon more and more purchasing power out of the “private sector” of the economy and into the “public sector.” Individuals who earn their own incomes, he argues, only spend them in trivial and foolish ways. Let the politicians seize more and more of the individual’s income and spend it as their own infinite wisdom dictates.

Alvin H. Hansen, the former Harvard economist, has now solemnized this theory with a new name—“the dual economy.” He agrees that private spending must be supplemented by massive Federal spending. The “private sector” and the “public sector,” he argues, support each other by mutual “exchange” just as do manufacturing and agriculture. Each sector “contributes to the total flow of real income and each takes its share out of the income stream either by charging a price or by collecting a tax.” Hansen can see no essential difference between voluntarily paying a price for something one wants and being forced to pay a tax for something one may not want nor even get.

### THAT ‘PUBLIC SECTOR’

In the summer issue of the *New Individualist Review*, Murray N. Rothbard subjects this concept of the “public sector” to realistic dissection. He points to its “hidden assumptions: That the national product is something like a pie, consisting of several ‘sectors,’ and that these sectors, public and private alike, are added to make the product of the economy as a whole. In this way, the assumption is smuggled into the analysis that the public and private sectors are equally productive, equally important, and on an equal footing altogether.”

But Rothbard goes on to point out the profound differences. Government acquires its revenues by coercion and not by voluntary payment. “Production” has a dubious meaning unless it means the production of things consumers demand and willingly buy. “In the private sector, a firm’s productivity is gauged by how much the consumers voluntarily spend on its product.



But in the public sector, the government's 'productivity' is measured . . . by how much *it spends!*"

### ADD OR SUBTRACT?

The truth, contends Rothbard, is that far from adding to the private sector, the public sector can only feed off the private sector; it necessarily lives parasitically upon the private economy. It directs production not toward but away from the needs of individual consumers. In brief, the public sector is "anti-productive; it *subtracts from*, rather than adds to, the private sector of the economy."

(I should like to add my own note that, while it may be reasonable to assume that certain necessary governmental services, like police and fire protection, add to national production, there is no possible way of determining *how much* they add. Of course schemes like foreign aid and subsidizing farmers to reduce output clearly reduce our national output and income.)

Rothbard also pays his respects to Galbraith's argument that private wants are all artificially induced by business advertising which automatically "creates" the wants it supposedly serves. If this were so, Rothbard points out, there would be no need whatever for the almost frantic concentration of business on "market research"—no reason to fear that one might make a product that people would not buy. As Rothbard remarks in conclusion, Galbraith is curiously silent on the enormous amount of propaganda *by government*.

Yet the Keynes-Galbraith-Hansen myth of the "dual economy," with its two chief "sectors," has become the new rationalization for a program of reckless and irresponsible spending that must inevitably lead us toward an inflationary crisis. ❁

## Too Much Labor Law

July 31, 1961

The Kennedy Administration, according to *Newsweek* (July 11) and *The Wall Street Journal*, plans to ask Congress for deep new Federal intervention in labor-management disputes, including the following powers:

1—Power to set up labor-dispute inquiry boards with "a lot more muscle" than those currently authorized by the Taft-Hartley law. They would be empowered to recommend settlement terms, not just find "facts." They could jump in at Presidential direction before a strike occurs.

2—Power to seize key industries, putting them under government management when deemed necessary to stop or avoid crippling strikes.

3—Power for the President to force strikers back to work by decreeing a "cooling-off" period without the present necessity of going to court and convincing a judge that a national emergency requires issuing an injunction.

These powers would amount to compulsory arbitration. They would in effect enable the government to fix wages. In the long run they would carry us into a completely controlled economy. A President could hand-pick boards to bring in the kind of decision he wanted. Settlement of every major strike would be thrown into politics. Few Presidents could resist the temptation to press for the settlement that seemed to yield the maximum political profit at the moment.

### YIELDING TO DEMANDS

This would mean substantially yielding to the unions' demands. As in the past, this would be disguised from the unsophisticated because the unions would always demand more than they actually expected to get. Anybody inclined to doubt this yielding has merely to notice what has happened even under the "weak" and "conservative" Taft-Hartley injunctions as they stand. The 1959 steel strike was finally settled (through the intervention of Vice President Nixon) only by a grossly inflationary wage increase. Settlements would be even worse if the government had still greater coercive powers.

The new powers would not reduce the number of strikes or strike threats, but immensely increase them. Whenever one of the compulsory arbitration boards "recommended" a settlement (which, as experience with the railroads proves, would be binding on the employers but not necessarily on the unions), 100 unions would contend that they were entitled to an equal wage increase or benefit, an equal "pattern." The government would soon be setting wages all around the circle.

### PENALIZE THE VICTIM?

The new powers would be almost certainly abused. Seizure of the companies would not penalize the strikers but the struck-against. During any tenure as operator, the government would be in a position to grant increased wages and other benefits which corporate managers could not easily rescind when they regained control. Truman tried to set a pattern like this when he seized—illegally—the steel companies in 1952.

With the Railway Labor Act of 1926, the Norris-LaGuardia Act of 1932, the Wagner Act of 1935, and the Taft-Hartley Act of 1947, Congress has tried to cure the evils brought on by government intervention in labor-management disputes by still more intervention. For a generation, the government has asked and Congress granted more and more "powers"—a larger and larger "arsenal of weapons," as Mr. Kennedy and

Secretary Goldberg call it. The situation has grown steadily worse.

And almost no one has dared to ask for the one clear remedy—the simple restoration of freedom. Not freedom for “collective” bargaining only but freedom for all bargaining—freedom for a minority union to bargain for its own members, freedom for any individual worker to bargain for himself, *legal* freedom for the employer to bargain with anyone, to hire, discharge, or replace whom he pleases. Plus protection for individual workers and employers against violence and coercion, or intimidation by mass picket lines.

In brief, the solution most likely to provide maximum labor peace, maximum wages, and maximum employment would be to repeal all Federal “labor-relations” laws and restore freedom of choice for the individual. ☼

## Irresponsible Budget

August 7, 1961

In his Budget Message of January 1960, President Eisenhower estimated there would be a surplus of \$4.2 billion in the fiscal year 1961. In January of this year he slashed his estimate to a thin surplus of only \$79 million. On March 25 President Kennedy estimated that instead of a thin surplus there would be a \$2.2 billion deficit in the fiscal year to end on June 30. When the final returns came in, the deficit turned out to be \$3.9 billion.

In January, President Eisenhower estimated a surplus of \$1.5 billion for the fiscal year 1962. In March Mr. Kennedy said that, instead, there would be a deficit of \$2.8 billion. Then the official estimate was raised to a deficit of \$3.7 billion. It is now raised again to more than \$5 billion.

These figures are in themselves evidence of fiscal irresponsibility. Our political leaders and Treasury experts seem unable to make a reasonably accurate estimate of a fiscal year's result even a couple of months before its end, let alone a year in advance. Recently the forecasts have been systematically wrong in the same direction—overestimating revenues and underestimating expenditures. Congress and the country have been faced with increased expenditure estimates almost every few weeks.

### ‘APPROPRIATE’ DEFICIT

Even more disquieting than this budgetary slovenliness is Washington's indifference toward it—as if it were not very important whether forecasts were wide of the mark or not. This goes back to the growing acceptance

in official circles of the belief that a budget balance is not important. Last March Mr. Kennedy said it really didn't matter whether the budget was balanced each year. All that was necessary was a “balance over the years of the business cycle.”

The implication was that a budget deficit would in itself bring the full employment that would bring the tax revenues that would eventually bring balance. Even a couple of months ago Secretary of the Treasury Dillon was saying: “Such a deficit [\$2 billion for 1961] is not a cause for alarm in times like these. . . . Another deficit is in prospect for fiscal '62, one of about \$3 billion. This, too, will be entirely appropriate.” In fact, the fashionable idea is that deficits are actually necessary for “creating demand,” for “full employment,” and for “growth.”

### URGENT TAX REFORMS

There is not room here to go over again all the fallacies and confusions in this view. But it may be worth pointing out that if a budget deficit *were* desirable, then the most desirable kind would be not one achieved by increasing government expenditures but by cutting taxes. Most of the deficit zealots want increased government expenditures to give increased “consumer purchasing power.” They overlook that what is enormously more important for economic growth and increased real wages and productivity is increased savings and *investment*, and that the way to get this is to mitigate the onerous taxes that now reduce incentive and production.

The most urgent reforms are more adequate tax write-offs for depreciation of plant and equipment, less drastic corporation income taxes, a revision of capital-gains taxes, and abolition of confiscatory progressive income-tax rates above 50 percent. Such reforms, in fact, would probably yield more rather than less revenues, and would give enormous stimulation to national output.

Instead of discussing this, Administration officials are now talking of an actual increase in taxes. This increase is said to be necessary to pay for the costs of defending Berlin. In view of the billions of dollars that the Administration has been asking and mainly getting for foreign aid, farm aid, social security, highways, and housing, it would be disingenuous to blame a tax increase on added Berlin costs. A boost in tax rates above present levels, moreover, might actually reduce tax revenues. It would certainly discourage investment and production.

The road back to fiscal sanity lies in recognizing that though budgets must be balanced, the *health* and growth of the economy demand that the balance be

achieved by cutting both excessive expenditures and excessive tax burdens. ☸

## Tax Cuts for Growth

August 14, 1961

It was not only right but imperative that President Kennedy give Khrushchev clear warning that we mean to defend Berlin at all costs. It was perhaps just as essential to show we were not bluffing by ordering an immediate build-up of our defenses. But the broader economic program outlined by Mr. Kennedy was unnecessary. It is more likely in the long run to thwart our national purposes than to help them.

The President told Congress that in order to improve our posture with regard to the defense of Berlin we need to spend \$3.5 billion more in this fiscal year. This is a total increase in the defense budget of \$6 billion since January. Suppose we accept the need for this \$6 billion. Why was it not asked for in May, when Mr. Kennedy requested only \$2.5 billion additional? The objective situation has not visibly changed. Khrushchev was threatening Berlin in May. We already knew then that he would threaten Berlin again and probably half a dozen other places. The new request gives an air of improvisation to the May request. It raises the question whether the present request may not also be improvised. Is Mr. Kennedy going to ask for new billions every time Khrushchev makes a new threat? That would give Khrushchev a cheap and easy way to lure us into spending ourselves into a runaway inflation or crushing taxation.

### SWOLLEN EXPENDITURES

The President's new requests raise his total defense budget to \$47.5 billion. Whenever any serious investigation has been made of military spending—by the Hoover commission or a Congressional committee—it has turned up huge waste and duplication. It is discouraging that Mr. Kennedy's reviews of the military budget have suggested no offsetting economies of any importance.

We come now to the non-defense budget. The overwhelming bulk of discussion consistently forgets that this is tremendous. The total Federal spending budget, including social security, exceeds \$100 billion. Non-defense expenditures exceed \$50 billion, or more than half. Yet not only has Mr. Kennedy not suggested any offsetting economies in any of these, he has poured into Congress since he came into office some 50 messages, nearly all of which have called for more spending in some new direction. In this \$50 billion of non-defense expenditures, covering every conceivable

activity, from aiding "depressed areas" to landing a man on the moon, there are infinitely rich opportunities for economy. Probably \$3.5 billion could profitably be cut out of either crop supports or foreign aid alone.

### NO BALANCE TILL 1963

Yet the President looks with complacency upon a budget deficit of more than \$5 billion in the current fiscal year (which still has nearly eleven months to run) on top of that of nearly \$4 billion for the fiscal year just closed. Not until the fiscal year 1963 does he promise a budget "strictly in balance." Even this balance, he hints, is to be achieved not by economies but by "an increase in taxes." Thus the President would put even more burdens on the already overburdened taxpayer. He neither asks nor hints at any sacrifices whatever for the multitudinous pressure groups that are now parasitic on the taxpayer.

But the necessity for reducing both government expenditures and taxes does not rest primarily on the argument for equity or fairness. It rests on the far stronger argument that this reduction is essential for promoting, instead of retarding, increased capital accumulation, production, and economic growth. We need to abolish all personal income tax rates above 50 percent. These bring in barely enough revenue to support the government for a half a week. They are confiscatory and purely punitive. If the personal income tax rates above 50 percent were abandoned, the revenues of the government would probably increase; the country's production would certainly increase.

There would also probably be more revenues and certainly greater national production and income if the double tax on corporate dividends were mitigated, if capital gains taxes were more realistic and less one-sided, and if more generous tax write-offs were allowed for depreciation and new investment. ☸

## The New Manifesto

August 21, 1961

The new 50,000-word *Communist Manifesto* is just one more missile in an uninterrupted war, blowing hot and cold, against the West. It is intended at least as much for U.S. consumption as for home consumption. And what it says has no necessary relation to what the Communist rulers seriously believe or intend.

It says, moreover, contradictory things. Some commentators attach great significance to Khrushchev's abandonment of the dogma of the inevitability of war between Communism and capitalism. Yet this has the obvious propagandistic advantage of inducing us



to relax our guard. Throughout the document, war is alternately threatened and disavowed. "The Communist Party of the Soviet Union . . . will continue to oppose all wars of conquest" (no mention of Tibet, Hungary, etc.) but "consider it their duty to support the sacred struggle of the oppressed peoples and their just anti-imperialist wars of liberation." In plainer words, any wars that the Russian Communists want to start (e.g., over Berlin) will be "anti-imperialist wars of liberation."

When Khrushchev says "We will bury you," and then talks of "peaceful coexistence," we in the West may regard it as double-speak. But for Khrushchev's propaganda purposes there is no contradiction. The threats to bury us are intended to scare some of us into appeasing him; the peaceful coexistence slogans are intended to lull and lure the rest of us into appeasing him. The "peaceful coexistence" will be obtainable—as long as we surrender to his terms, on Berlin, a divided Germany, Laos, Cuba, until we have lost the will or power to resist. The new manifesto aims at sapping our moral resolution and our faith in our own cause and system.

#### HOMAGE TO PROFIT

The manifesto is for the most part a rehash of practically all the stale Marxist dogmas about the inevitable triumph of socialism and Communism and the equally inevitable disintegration and defeat of capitalism. As part of the double-speak, there are attacks on "dogmatism" but even stronger attacks on "revisionism." Yet revisionism occasionally raises its ugly head. We are suddenly surprised to discover, for example, that: "Prices must, to a growing extent . . . insure . . . a certain profit for each normally operating enterprise." In the older literature of Communism, "profit" was a dirty word; it existed under capitalism only because employers "exploited" the workers by "withholding" from them the full product of their labor. If profit is now normal and necessary even under Communism, why is it so reprehensible under capitalism?

Here are the pie-in-the-sky promises for 1980 which the manifesto makes: "The people's standard of living and their cultural and technical standards will improve substantially; everyone will live in easy circumstances; all collective and state farms will become highly productive and profitable enterprises; the demand of the Soviet people for well-appointed housing will in the main be satisfied; hard physical work will disappear; the U.S.S.R. will become the country with the shortest working day."

#### PROMISE VS. REALITY

People like Senator Fulbright take this sort of pipe dream in deadly earnest. He tells us that Russia can achieve these goals, that "the big question is the maturity

of our response," and that "we must *also* develop our economy." Such people, bewitched by the phony statistics that Russia is constantly publishing, ignore the miserable conditions that still exist there after 44 years of Communist rule—slave-labor camps, people packed six to a room in huge slums with communal kitchens and bathrooms, women working like beasts of burden, lands ravaged by chronic crop shortages, and recurrent famine.

The Soviet economic achievement, except in the few things on which they have concentrated their resources and their efforts—armament, missiles, and spectacular space stunts—has been wretched. Though they are still far behind us (and even most countries of Europe), they are always *going* to pass us in the sweet by-and-by—this time twenty years from now, when the people who are making these extravagant promises will not be around to be held responsible for their non-fulfillment. ☸

## Foreign-Aid Fallacies

August 28, 1961

The Administration's foreign-aid program disregards nearly every sound principle of constitutional balance, foreign policy, or economics.

Even if we were to grant that a foreign-aid program of the present dimensions is economically necessary or desirable, the request of the President for authority to borrow \$8.8 billion from the Treasury over the next five years to finance long-term "development" loans violates sound democratic and constitutional procedure. Congress is asked to give up, to that extent, its essential annual control of Federal expenditures. It is asked, in other words, to vote a lack of confidence in its future self. It is asked to prevent itself from reconsidering the program next year on its merits, and deciding the question in accordance with its judgment of the situation as it exists at that time.

It is also asked, in effect, to limit the freedom of action of the *next* Congress. If the voters were to return a conservative or a Republican House to power in November 1962, for example, and the new members felt that part of their mandate was to cut down or halt foreign aid, they would be prevented from doing so by an unwarranted "moral commitment" made by the present Congress. This is a denial of democratic principle.

#### FIVE YEAR PLANS

The President's request rests, in addition, on unsound economic assumptions. The Rusk-Dillon plea declared:



"It will be necessary to free our development lending program from the difficulties of working under the uncertainties inherent in annual requests for funds." Why can't foreign governments operate under the same "uncertainties" as our own government departments do? The Administration's argument apparently assumes that the key to prosperity and economic growth is not free enterprise, but government planning, as typified by the Five Year plans that India and other nations have aped from Russia.

President Kennedy and Secretary Dillon have promised huge sums to Latin American countries in our Alliance for Progress on condition that they institute "reforms." These reforms are not in the direction of encouraging free enterprise, removing vexatious controls, safeguarding private property, reducing onerous taxation and government extravagance, balancing their budgets, and halting inflation. The money has been offered on the contrary, on the condition that the Latin American countries will undertake "national [i.e., governmental] planning," "land reform," and socialized housing—in brief, if they will move still further toward socialism and the welfare state. So-called "land reform" abroad has usually meant a grave infringement of private-property rights. It has more often resulted in a reduction rather than an increase of agricultural output.

#### WHAT PRICE COFFEE?

Secretary Dillon has promised the Latin American countries "at least \$20 billion" in return for such socialistic measures. In addition, he has promised help in pushing up the price of coffee and tin, for example, against American consumers. He has not only endorsed export quotas of these products from Latin American producers, but recommended policing imports into the U.S. He ignores the collapse of all the old Brazilian coffee valorization plans and similar "stabilization" schemes, and the expensive fiasco of our own crop-support programs.

In brief, the Administration does not trust or understand the function of free prices and free markets in adjusting production to consumption and supply to demand. The whole folly of government price-control and production-control is to be launched on a new and international scale.

The result can only be to encourage and prolong all the unsound economic policies of South American governments, and to slow down rather than accelerate sound and continuous South American economic growth.

All this is apart from the economic harm that the foreign-aid program is now doing to the United States itself, in unbalancing our budget, threatening greater

inflation and a still greater increase in the tax burden on productive enterprise, increasing the deficit in our balance of payments, and undermining the dollar just when it is most essential for our own stability and world stability to strengthen it. ❀

## Hostility to Business

September 4, 1961

Growing signs of hostility to business on the part of prominent members of the Kennedy Administration culminated in the indictment on Aug. 17 of three of the nation's largest manufacturers of antibiotics and three of their top executives on criminal antitrust charges. The defendants were accused of maintaining unreasonably high and noncompetitive prices, and of monopolizing production and distribution of the drugs.

The legal guilt or innocence of the defendants must be determined by the courts. But something may be said about the curious ideas of the Administration concerning what constitutes "noncompetitive" pricing. Unless identical or equivalent products are offered at the same price, the overpriced product cannot be competitively sold. Yet the Federal government seems to regard such equality of pricing as a *prima facie* sign of conspiratorial price-fixing.

An even broader question is raised by the existing anti-monopoly laws themselves. Apart from the specific wisdom of some of these laws, it is the first requirement of the ideal of the Rule of Law that laws ought not to discriminate between groups or persons. Equality before the law means that whatever is permitted to A is permitted to B, and whatever is forbidden to A is forbidden to B.

#### DOUBLE STANDARD

But for the anti-monopoly laws there is a flagrant double standard. Labor unions are not only permitted to do what is forbidden to businessmen, but employers are compelled by Federal law to deal with these labor monopolies. Unions are in practice even allowed to enforce their demands by physical intimidation and violence, to prevent others from taking the jobs their members have voluntarily vacated. The country's farmers for decades have not only been permitted to engage in monopolistic price-fixing; they had done so with government help, and even under government coercion. Not so long ago the coal industry was forced to fix minimum prices by Federal law. Before that all industry was forced to fix prices under the NRA code.

It would be hard to think of an industry that, in the last twenty years, has conferred a greater boon on the American people, and on humanity, than the American drug industry. It has made an enormous and unmatched contribution to relief from disease and pain, and to the prolongation of human life. Yet instead of winning praise and gratitude for this, it has only aroused the animosity of the politicians. Last week my colleague Raymond Moley discussed the extraordinarily one-sided investigation that the Kefauver Senate subcommittee has conducted for several years against the industry, with hearings published in 26 volumes comprising 16,505 pages. He also discusses this week some questions of prices and profits in the drug business. I should like to supplement this with some considerations that apply also to the role that profits play in business generally.

### BENEFICIENT INDUSTRY

Ignoring the hundreds of thousands of lives that the American drug industry has prolonged or made more worth living, Senator Kefauver concentrates on the suspicion that the companies may have overpriced their drugs by excessive markups. The drug industry has replied that the average person spends no more of his health dollar, and a smaller portion of his income, for drugs today than he did in 1929.

It is true that the drug industry in recent years has made higher profit margins than most industries. This has been fortunate for the country. It has provided the funds for research to develop new and better drugs. It has led to the expansion of the industry. It has attracted more firms into it. The research has brought down some prices sensationally. The competition has also brought down prices. In a free system, the cure for high prices is high prices.

The political hostility to the drug business, the attempt to treat the heads of the big drug companies like common criminals, and put them in jail, because their pricing policies may not conform with the naïve preconceived ideas of politicians, must threaten the growth and potential usefulness of one of America's most beneficent industries. ☸

## Aid vs. Trade

September 11, 1961

Two recent actions by the Administration emphasize the deep confusion that exists about the causes and cure of the "deficit" in our balance of payments. One was the announcement that the United States would shift from European to domestic producers for the coal and

coke it needs to supply its forces in West Germany. The other was the reduction in the duty-free allowance of Americans returning from abroad from \$500 worth of goods each to only \$100 worth. Both actions were taken on the argument that they would improve the U.S. balance of payments.

The first thing that strikes one about these actions is the utter insignificance of the sums involved compared to the size of the problem. The deficit in the balance of payments has been running into billions a year. Our foreign aid, consisting mainly of gifts and soft loans, is more than \$4 billion a year. The annual cost of the coal our forces use in West Germany is placed at \$15 million. In the present fiscal year, 40 percent has already been contracted for in Europe, leaving about \$9 million worth to be bought. So against the \$4 billion we give away in foreign aid we "save" \$9 million on coal, or roughly one-fourth of 1 percent. Put another way, we are to give in foreign aid 400 times as much as we "save" on the cost of coal. What we "save" in foreign exchange by cutting the duty-free allowance of American tourists is also insignificant.

### BREEDING ILL WILL

Both actions are unwise from the standpoint of our foreign relations. The State Department is said to have opposed the decision to buy coal for our West German forces here because the German industry is also in economic difficulties. Our reduced tourist allowance will do great damage at special points—for example, at Curaçao, where Caribbean tourists stop largely for the "bargains." We spend enormous sums to try to buy foreign friendship, and then offset them by petty "savings" that breed ill will.

These actions reveal above all a complete misunderstanding of the meaning and causes of a "deficit" in the balance of payments and the consequences of trying to cure it by reducing imports.

Let us consider first the differences between a *real* deficit in the balance of payments and a *technical* one. A real deficit is created by foreign aid—by goods (or dollars) that we give away for nothing tangible in return. A technical deficit in the balance of payments is the excess of gold and dollars that are transferred to foreigners on commercial account above those we get back. We may call this a technical deficit because the gold or money has not been lost; we have bought something in return for it.

### IMPORTS AND EXPORTS

The point about a technical deficit is that, if a country avoids inflation or if it allows freedom of exchange rates, such a deficit will always tend to correct itself. The reason is simple. There is no advantage in foreigners' holding

on to that country's currency forever. Eventually they must buy something with it—in that country. Given free prices and free currencies, changes in comparative prices or in exchange rates must in time correct payments deficits.

The present deficit in the American balance of payments has been brought about by unsound government policies over a long period. We have domestic inflation, reflected in costs, wages, and prices, making American goods high in price, and foreign goods comparatively attractive. We have a dollar overvalued in terms of gold, combined with arbitrary exchange rate fixity. Gold, which has not gone up in price in 25 years, is our biggest bargain for foreigners.

This situation cannot be corrected by discouraging imports. By the exact amount that we cut down our purchases from abroad, we ultimately cut down our sales abroad, by depriving foreigners of the dollar purchasing power to buy them. We compound our problem by paying up to 25 percent more for the coal we buy at home. Ironically, what we discourage is sales to us that enable foreigners to earn dollars to buy from us. We much prefer to give dollars away, while increasing the inflation that causes the payments deficit. ❁

## In Defense of Gold

September 18, 1961

Between 1946 and 1954 the eminent French economist Charles Rist, who died in 1955, wrote a series of articles advocating a return to the international gold standard. He published these as a short book. Now Philip Cortney has performed a public service by translating this into English, under the title *The Triumph of Gold* (Philosophical Library, \$4), and writing an introduction.

Rist's central theme is that gold is the only metal capable of serving as a base for international commerce, because it is the only one that is asked for and accepted in payment in all countries, as bullion or in the form of money. It holds its value because of the rarity imposed on it by nature. It is precisely this rarity and this retention of value over time that makes it infinitely superior to paper money. The demand for it, as money, has existed since the beginning of history.

Rist devotes a great deal of his space to answering the specious arguments offered in defense of paper money. For many writers, he points out, contempt for gold is a new idea and praise of paper money an original thought. The history of ideas about money shows, on the contrary, that this is a very old conflict.

## JOHN LAW

Rist's book is beautifully lucid and readable. One of his most fascinating chapters is that in which he traces current arguments and even phrases denouncing gold and praising paper back to the Scottish adventurer John Law, who instituted a paper-money system in France and defended it in letters published in 1720.

Rist reminds us that Law suspended the convertibility of bank notes in order to issue larger quantities. In order to prevent the depreciation of the paper from being apparent in exchange for gold or silver, he forbade the possession of gold and silver by the public, "exactly as was done by President Roosevelt in 1933." Law ordered searches in homes. He encouraged denunciations. He seized silver deposited with notaries and in savings banks and replaced it with paper money.

Rist believed that only by a return to a full international gold standard could the world get back to monetary stability and insure the continuance or resumption of a truly international economy. But he did not believe it would be possible to retain the gold value of the dollar at \$35 an ounce. Any effort to do this, he was convinced, would precipitate an American and a world deflation that would have consequences equivalent to those of the depression of 1929.

## \$70 AN OUNCE?

He looked forward to action on the part of the United States, or a world conference, to revalue gold in terms of currencies and prevent such a deflation. "It will become indispensable not, as is currently said, to modify the price of gold in paper dollars, but, more correctly, to modify the price of the paper dollar in gold."

Though he saw that the problem would involve difficulties, uncertainties, and chance, his opinion (in 1952), on the basis of the price rise and the currency increase that had taken place since 1940, was that the price of gold should be raised from \$35 to \$70 an ounce.

Philip Cortney, in an introduction that pleads eloquently and convincingly for a return to the gold standard, and dissects further arguments of the defenders of a managed paper money, also, and with more confidence than Rist, insists that "the price of gold will have to be raised to at least \$70 an ounce."

I find myself in agreement with Rist and Cortney on practically every point but the exact procedure for getting back to gold convertibility at a new valuation for the paper dollar. I am inclined to believe, though I am not sure, that a price of \$70 an ounce might be strongly inflationary. A safer way to proceed, in any case, would be a temporary suspension of export of the government's gold supply, accompanied by authorization of a free gold market. This would help the government



in fixing a tenable new gold value for the dollar. What cannot go on is continued inflation and a continued adverse balance of payments accompanied by the right of foreign central banks to withdraw all the gold they want until our supply is exhausted. ❁

## An International Order

September 25, 1961

TURIN—Economists and political scientists from eighteen nations met (Sept. 3 to 9) in this Italian city to discuss some of the world's political and economic problems.

They are members of the Mont Pèlerin Society, named after the place where it first met in Switzerland fourteen years ago. The original meeting was attended by only 47 persons from little more than half a dozen countries—the U.S., Britain, France, Italy, Switzerland, Belgium, Holland, and Norway. Chiefly under the leadership of F.A. Hayek, author of *The Road to Serfdom*, who became the society's first president, the group was united by a common belief in libertarian principles—in limited government, in free, private, competitive enterprise, in the lowering or abolition of the barriers to international trade, in the restoration of a world monetary order, in the restoration of a Rule of Law, internally and externally. They were against the network of price controls and exchange controls that then existed, against the drift into socialism, collectivism, national planning, and the welfare state, that seemed so irresistible in Europe and so fashionable in the U.S.

The group that met in 1947 felt isolated. Those especially who came from Continental Europe thought of themselves as “liberals,” and called themselves that; but their principles—of traditional liberalism—were regarded as reactionary, outmoded, and unreal by their socialist and welfare-statist colleagues in the academic world. For the great majority of those who met were university professors.

### MEN OF INFLUENCE

In the following decade, however, the Mont Pelerin Society met with more success than its original members had dared to hope for. Its membership now exceeds 200, from more than twenty countries, including non-European countries such as Japan, India, Argentina, and Peru. And its membership, though still dominantly made up of professors and scholars, includes men who occupy or have occupied positions of great influence or power in their own countries—Sen. Luigi Einaudi, former President of Italy, Dr. Ludwig Erhard, Economics Minister of West Germany, Jacques Rueff, author of the

Rueff economic program in France, Pedro Beltran, the Premier of Peru, to name a few.

The original members of the society have lived to see stifling economic controls, internal and external, lifted in a score of countries, currencies stabilized, inflations in many countries brought to a comparative halt, and a wide disenchantment with socialist panaceas. Some of the members have been influential in bringing about these reforms. But they have acted always as individuals. The society is in no sense a propaganda organization; it has no platform, program, or declared statement of principles. It meets purely for the exchange of ideas, and though it is pervaded by a libertarian philosophy and spirit, there are differences of opinion on details.

### GLOBAL TOPICS

At the meeting the members discussed such topics as the relationship of democracy and liberalism, the responsibilities of the Western countries to the underdeveloped areas, the status of Communism, particularly in Italy, France, and South America, and the possibility of a return to an international monetary order.

Again, in the shadow of the Berlin crisis and the threats and actions of Khrushchev, many members expressed the deepest misgivings about the outlook for economic order and freedom. Yet there was a surprising area of agreement among the recommendations of individual speakers for national and international currency reform. What was remarkable was the almost unanimous conclusion that the only alternative to inflation and continued monetary chaos was a restoration of the international gold standard.

There was, to be sure, some dissent from this view. There was even more disagreement among individual speakers concerning the exact method of returning to a full gold standard and of adopting new currency unit values in terms of gold. But not a single speaker expressed satisfaction with the present International Monetary Fund system. Several, indeed, dismissed it as a pseudo-gold standard, a “gilded” standard with a built-in world inflationary bias. ❁

## Secret of Switzerland

October 2, 1961

ZURICH— Apart from reports of international conferences, Switzerland is less in the news than any other country of comparable importance. No revolutions, popular or palace, no upheavals, no government crises, no new five-year economic plans, no “austerity” programs, no inflation or deflation crises, no “dollar



shortage," no demands for aid. Unlike so many other countries, in short, Switzerland is not constantly being threatened with collapse and as constantly being saved.

In part this must be attributed to the character of the people. The passion for tidiness, order, and good management seems more widespread here than among any other people in the world. It is reflected not only in the cities and parks, but in a countryside so beautifully kept that it seems like one enormous golf course.

But at least as much credit must go to Switzerland's form of government and the spirit in which it is carried on. It is first of all a federal government, like our own—or like what our government was originally, and largely remained, until the tremendous centralization of power in Washington following two world wars. Most of the governmental power is in the 22 cantons, as ours was originally in the States. And there is no final power even in the federal Parliament. If 30,000 citizens don't like a law, they can force a referendum on it and the people can veto it. Such referendums may occur two or three times a year. The upper house is modeled on our Senate, with two members from each canton. The lower house is elected on the basis of population.

#### NO VETO

But the great blessing of Switzerland is that it has no "strong" man, no "indispensable" man, and cannot have under its constitution. The two houses of Parliament together elect a Federal Council, consisting of seven members, and one of these is elected President of the Confederation for a term of one year. He cannot succeed himself (except theoretically after the expiration of another year) and in practice the Presidency is rotated annually among the seven members of the council. The President has few powers, and cannot veto bills. The result is that not many outside of Switzerland even know the incumbent President's name. (It happens at the moment to be Wahlen.)

So, while people everywhere wonder what would happen in France without de Gaulle, in Spain without Franco, in India without Nehru, and so on, no one worries what would happen in Switzerland without Wahlen. Everything, it is assumed, would continue to be stable, orderly, and predictable with or without him.

And Switzerland has managed very well. In the calendar year 1960 it had a budget surplus of 279 million francs. In 1959 the budget surplus was 163 million. This year another surplus is expected. The national debt has been reduced from 8.5 billion francs in 1945 to 6.2 billion today.

#### GOLD BASIS

For a number of years now, Switzerland has boasted "the hardest currency in the world." It is on a real gold

basis. Any citizen can turn in his francs for gold. The gold coverage—about 10.5 billion francs—is more than 150 percent of the 6.8 billion francs in circulation. Gold has come to Switzerland as a result of its hard-money policy, and the Swiss today deliberately "sterilize" part of their gold supply to prevent inflation. But little Switzerland is like an island threatened by the great tidal waves of international currency disturbances, and such disturbances anywhere—inflation in the U.S., the drop in the Canadian dollar, even the recent upward valuations of the Dutch and German currency units—worry Swiss economists and bankers.

The Swiss economy is bursting at the seams. Not only is there practically no unemployment, but Switzerland has had to import about 500,000 foreign workers, mainly Italian and Spanish. As the population of Switzerland is only 5.4 million, this foreign influx of workers is substantial.

One of Switzerland's most important problems at the moment is the future of its foreign trade. It does not like the idea of joining the Common Market, which it regards as a political organization not compatible with Switzerland's traditional neutrality (It is not a member either of the IMF or even the U.N.) But, if Britain joins, Switzerland's hand may be forced. ☸

## Galbraith Revisited

October 9, 1961

Over the last twelve months I have on one or two occasions examined the economic ideas of J. Kenneth Galbraith, our present ambassador to India, as expounded in his book *The Affluent Society*. This examination seems justified by the great influence of his ideas not only in academic circles but in the Kennedy Administration. Galbraith's ideas were the subject of discussion at a meeting of the Mont Pèlerin Society, an international group of economists, a year ago in Germany; but the full text of the discussion has only now become available in *The Mont Pèlerin Quarterly* dated April–July 1961. It provides an opportunity to examine his ideas afresh.

So many good points were made by several speakers that the task of selection is difficult. The main thesis of Galbraith's book, as summed up by Prof. George J. Stigler, "is that we are now wealthy and that an economic theory and a viewpoint which are based upon general poverty and the need for efficient production are obsolete." Galbraith's message is also summed up by Prof. David McCord Wright as: "Escape from the thrall of productive efficiency—stick to the

out-of-date method, don't adjust, do less work." The disastrous effects of such a program upon American capacity and world growth are obvious.

### WE SILLY SPENDERS

Stigler points out that if we accept Galbraith's thesis that people are essentially silly in spending their income, and fall for the blandishments of persuasive advertising by buying trifling or wholly nonsensical or harmful commodities, we are likely also to believe that people are stupid in other departments of life: "It is a very short step to say that not only are they incompetent in disposing of their money, but that they obviously are incompetent in disposing of their votes intelligently."

George Schwartz points out that: "One of the greatest pleasures in life is to disapprove of the way the people next door spend their money. I bet that every woman in the world does not think much of the curtains chosen by the woman next door." He adds that the Galbraith thesis is just a new twist to the anti-capitalist argument: "Admittedly the capitalist order can turn out the goods; admittedly it can provide a high degree of employment . . . Now if you make all those admissions what have you got to sell? The Galbraith line is just a desperate turn to something new, to the argument: 'All right, the goods are there, but they are the wrong goods'."

### 'DEPENDENCE EFFECT'

Prof. F.A. Hayek contends that the Galbraith argument really turns upon the "Dependence Effect" explained in Chapter XI of *The Affluent Society*. This argument starts from the assertion that a great part of the wants which are still unsatisfied in modern society are not wants that would be experienced spontaneously by the individual if left to himself, but are wants which are created by the process by which they are satisfied:

"It is then represented as self-evident that for this reason such wants cannot be urgent or important. This crucial conclusion appears to be a complete *non sequitur*, and it would seem that with it the whole argument of the book collapses.

"The first part of the argument is of course perfectly true: We would not desire any of the amenities of civilization—or even the most primitive culture—if we did not live in a society in which others provide them. The innate wants are probably confined to food, shelter, and sex. All the rest we learn to desire because we see others enjoying various things. To say that a desire is not important because it is not innate is to say that the whole cultural achievement of man is not important. . . . How complete a *non sequitur* Professor Galbraith's conclusion represents is seen most clearly if

we apply the argument to any product of the arts, be it music, painting, or literature."

And Hayek, too, points out that the Galbraith thesis merely reverses the old socialist argument: "For over a hundred years we have been exhorted to embrace socialism because it would give us more goods. Since it has so lamentably failed to achieve this where it has been tried, we are now urged to adopt it because more goods after all are not important." ❁

## False Internationalism

October 16, 1961

LONDON—The main impression left by a month's visit covering France, Italy, Switzerland, Austria, and the British Isles is that the political and economic problems of individual countries are today overshadowed by their common international problems. By this I do not mean only the threat of a third world war of unparalleled devastation, but immediate day-to-day problems. We are witnessing, for example, an almost simultaneous crisis in the international organizations that were set up in 1945 or later with a great flourish of trumpets, based on utopian hopes, emotional catchwords (like "one world"), and false political and economic assumptions.

The main crisis is in the main organization, the United Nations. This is not merely the result of the death of its Secretary-General, Dag Hammarskjöld, but of cumulative experience of the ineffectiveness of the U.N. in solving or averting any major dispute or crisis. Nearly five years ago, even before more than a score of tiny new Asian and African "nations" were created and admitted, Viscount Cherwell pointed out that in the Assembly, "the ultimate governing body of the U.N. . . . 5 percent of the world's population can carry the day against the other 95 percent." To rely on the U.N., he thought, was "to live in a fool's paradise." It is "nonsense," he concluded, for nations to submit their "vital interests to a body so absurdly constituted."

### COMMON MARKET

The culminating result is the spectacle in the Congo of the United Nations resorting to military force to try to compel Katanga to get rid of its Western advisers and "unite" under a Communist-dominated confederation. This denial of the right of self-determination, elsewhere one of the great slogans of the U.N., has shocked a substantial section of British opinion. Many Britons are baffled by the apparently incurable determination of our government to abdicate its own moral responsibility and put its conscience in the hands of other nations.

The British are having their own troubles with one of the new international organizations, the Common Market. They are deeply divided on the wisdom of joining it. They fear that the political result may be to break up the Commonwealth. They are not sure whether the economic result will be to carry them in the direction of freer trade or of more protection. For if they would have to lower their tariffs against European industrial goods, they fear that they might have to raise them against agricultural products and raw material from the Commonwealth as well as other countries. If there were a true world will to freer trade, some point out, no such discriminatory organization as the Common Market would be needed. Each nation would simply reduce its own tariff barriers and accept the nondiscriminatory most favored-nation principle.

### **MONETARY FUND**

One international organization certain to get more critical scrutiny than it has ever received before is the International Monetary Fund. The U.S. Government is trying to postpone the necessity for putting its monetary house in order by building up the reserves and lending capacity of the fund. But it is becoming clear to the world's monetary economists that the fund, with its credits and "drawing rights," has been a powerful contributory force in keeping world inflation going. There is ultimately no substitute for each nation's responsibility to keep its own currency sound.

This responsibility devolves above all on the U.S. As Groseclose, Williams & Associates put it in a recent (July–August) *Washington Letter*: "With dollars and sterling (mainly dollars) as 45 percent of the backing of the free-world currencies, the importance of a sound dollar to the free world is plain. The maintenance of the value of the dollar thus becomes the most important task of the U.S. Government both at home and abroad.

Yet, ironically, we are undermining the value of the dollar by a huge domestic spending program, a huge "foreign-aid" program, cheap-money policies, and a prospective deficit this fiscal year of more than \$6.5 billion. Where we could have helped other nations most by keeping ourselves strong, we are threatening world stability by weakening our own position. ❁

## **Can Statistics Predict?**

October 23, 1961

In 1957 the Council of Economic Advisers suggested that the Census Bureau, with the cooperation of the National Bureau of Economic Research, a private

statistical organization of high standing, "develop methods of appraising current business fluctuations in a monthly report that would take advantage of new findings about . . . economic processes over time, the availability of a great many economic time series, and large-scale electronic computers."

As a result, Julius Shiskin took a leave of absence from his job as chief economic statistician at the Bureau of the Census to make a study for the NBER. The results now appear in a report entitled: "Signals of Recession and Recovery: An Experiment With Monthly Reporting."

To estimate what Shiskin and his associates have accomplished, let us look first at the problem they were given to solve. As an aid in predicting the future of business, or even in ascertaining its present state, statisticians, private and governmental, have developed over the years an increasing number of statistical "series." Shiskin estimates that in *Economic Indicators*, the *Survey of Current Business*, the *Federal Reserve Bulletin*, and magazines and newspapers, there are now well over 2,500 aggregate and component monthly or quarterly economic series. They cover an immense range of economic activity.

### **ROLE OF COMPUTERS**

Obviously "this enrichment of the data available," as Shiskin points out, "was not an unmitigated boon for the analyst. . . . It was beyond the resources of any individual . . . to carry out the calculations, such as seasonal adjustments, needed to make the series useful for current business cycle analysis." Fortunately, "a major breakthrough came in the early 1950s, with the advent of the large-scale, general-purpose electronic computer." A computer program can "adjust and summarize" statistics quickly, and give "early-warning signals" of business recessions and recoveries.

So Shiskin takes 65 economic indicators and presents elaborate tables showing their "behavior in past business cycles." It will take time to assess the value of his result. They will begin to be tested on Oct. 23, when the Department of Commerce will initiate a new monthly report, showing how some 70 different "economic indicators" have acted during the preceding month. These will include at least 29 indicators that usually lead the business cycle, fourteen roughly coincident with it, and seven that have usually lagged behind. A few preliminary observations may be made:

1—Electronic computers are amazingly quick, but there is no scientific magic in them. They can give only the answers that are fed into them. If statisticians feed in the wrong kind of "adjustments," weights or averages, computers will make the wrong kind.



2—Statistics, even statistics that “lead” the business cycle, such as stock prices or length of the average work week, are always the record of past events. As Ludwig von Mises has put it, statistics are history.

3—Even if we assume that the future is inevitably determined by the past, statistics give too partial a picture. They are mere abstractions and averages. They leave out, among other things, all the political decisions or events, domestic or foreign, that profoundly affect business.

4—Shiskin and his associates think better business indicators will help the *government* to fight depressions and keep business on an even keel. But free markets can do this better than anything else. Governments always seek perpetual boom.

5—It is not correct foresight itself that yields profits, but only better foresight than the majority.

6—Business predictions themselves affect the future they predict. In fact, as Albert Hahn has pointed out, if the business cycle were predictable, there would be no cycle, as everybody would hedge against it.

Let us welcome the new statistical series. It should help us collectively, and no businessman can afford to be ignorant of the results. But those results can never be conclusive or completely “scientific.” The future will always be uncertain. The individual businessman, as always, will have to rely also on his knowledge of special situations and on his own hunches. ❁

## Shadow of Price Control

October 30, 1961

In a letter of Sept. 6, Mr. Kennedy warned the heads of twelve major steel companies that if they raised their prices to cover the further increase in steel wages on Oct. 1 they would be contributing to inflation. The President’s policy on this matter could have fateful consequences not only for the steel industry but the whole American economy. It is gratifying, therefore, to find the subject so ably analyzed in the current October monthly letter of the First National City Bank of New York.

The best factual reply to the President’s letter came from Roger M. Blough, chairman of United States Steel. Among Blough’s points:

1—“From 1940 through 1960 steel prices rose 174 percent, but the industry’s hourly employment costs rose 322 percent, or nearly twice as much. I use 1940 as a starting point rather than 1947 [as the President did] because during the war-affected years of 1940 through 1944 steel wages rose substantially as did the level of

wholesale prices; but steel prices increased not at all. Any comparison of these trends which starts with post-war 1947 as a base therefore obscures rather than reveals the realities which the steel companies have had to face throughout this entire period of inflation.”

2—“Profits [as a percentage of sales] have only once in the past twenty years equaled the 8 percent level at which they stood in 1940 and have averaged only 6½ percent in the past five years, thus demonstrating clearly that steel price increases during this period have not fully covered the rapid rise in total steelmaking costs.”

3—“The industry’s profit rate is merely an average—and averages can be dangerously misleading. Some companies will earn more than the average, while some may be suffering losses which they cannot sustain indefinitely. So it was in 1960 that among the 30 largest steel companies the profit rate as a percentage of sales ranged from a plus 9.3 percent to a loss of 5.2 percent.”

In addition to such factual points, Blough made some more general observations. He stressed one conclusion from a government report last year, prepared for the Department of Labor by Professor Livernash of Harvard University: “Obviously while price policy can be debated in the short run, in the long run all cost increases must be met. Steel has done no more than this.”

What alarms the City Bank is a broader issue than steel prices. Though the President’s letter was moderate in tone, behind it seemed to lie the threat of a general price control. A few weeks earlier Sen. Albert Gore had suggested that the Federal Trade Commission “could move to police the steel industry,” that the Department of Justice could perhaps break up the big steel companies, and “lastly, if all else fails, steel prices can be brought under utility-type regulations.”

### REPPRESSED INFLATION

“There are worse things,” comments the City Bank, “that could happen to this country than an increase in the price of steel. One of these is the destruction of the freedoms of the market place and the substitution of political price-fixing, beginning with steel and spreading perhaps throughout industry. If nothing else, our wartime experiences with price-setting bureaucracies, black markets, and deteriorations of quality should warn us against this course.”

From the end of World War II until a few years ago, the same government policy repeated itself depressingly in one European country after another, as it is repeating itself now with even greater violence among our South American neighbors. This is the policy of “repressed



inflation.” It consists, on the one hand, in creating inflation through government encouragement of excessive wage increases, huge government spending and deficits, and cheap-money policies, and then throwing the blame on business and trying to prevent the inevitable price rise by price controls. The price-fixing does even more harm than the inflation itself. It misdirects, unbalances, and disrupts production, and breeds class hatreds by directing suspicion against businessmen and producers.

This is the direction in which we seem to be drifting. But with courage and clarity, there is still time to reverse our course. ❁

## In the Sweet By and By

November 6, 1961

*Let me repeat so there will be no mistake: The President intends to submit to Congress next January a balanced budget for fiscal 1963.*

Secretary of the Treasury  
Douglas Dillon, Oct. 17.

This pledge is reassuring. Yet the record of the past makes it less reassuring than it could have been. In January President Eisenhower estimated a surplus for the fiscal year 1962 of \$1.5 billion. In March Mr. Kennedy said that, instead, there would be a deficit of \$2.8 billion. Then the official estimate was raised to a deficit of \$3.7 billion. In July it was raised again to \$5.3 billion. On Oct. 29, the Budget Bureau estimated the deficit would be \$6.9 billion.

If the estimated budget deficit even for the current fiscal year is to be raised by another billion dollars or so every couple of months, what real assurance can we have that the President will present a balanced budget estimate next January and that, come June 30, 1963, such a balance will in fact be realized?

It is argued that the estimated budget deficit has had to be unexpectedly raised in recent months because of the Berlin crisis and the need to increase defense spending. But even if we accept every dollar of our military spending as absolutely necessary, most of our annual Federal expenditures—more than \$50 billion, if we include social security—are for civilian purposes.

### NON-DEFENSE BUDGET

This includes all the dubious billions spent on foreign aid or farm price supports. It includes all the new billions recommended in the 50 or so messages that

President Kennedy has so far sent to Congress. When a prudent individual finds that he has to spend more on some unexpected emergency, such as illness in his family, he normally cuts down his spending on something else. But the Kennedy Administration, instead of reducing its civilian spending plans when faced with a bigger defense budget, keeps adding to them.

Making a scapegoat of defense spending has, in fact, become a shopworn device. On Jan. 4, 1940, President Roosevelt said: “For several years we have been compelled to strengthen our own national defense. This has created a very large portion of our Treasury deficits.”

If it is possible to balance the budget, why must we wait until fiscal year 1963? Why not try it in the current fiscal year, which still has eight months to run? Why can the budget never be balanced this year but only in some sweet by-and-by?

### NEVER THIS YEAR

I raised this question in a *Newsweek* column (Nov. 2, 1953) and cited the sad record of three Administrations. Space permits only a few elliptic quotations:

*Franklin D. Roosevelt*: “I give you assurance that . . . within a year the income of the government will be sufficient to cover the expenditures of the government”—March 10, 1933. “We approach a balance of the national budget”—Jan. 3, 1936. “If [the national income] keeps on rising at the present rate, as I am confident it will, the receipts [of the government] . . . within a year or two, will be sufficient . . . to balance the annual budget”—Oct. 1, 1936. (The budget was never balanced in any of the twelve years that FDR was in office.)

*Harry S. Truman*: “The budget for the fiscal year 1949 . . . will be balanced . . . and provide \$4.8 billion which should be used to reduce the public debt”—Jan. 12, 1948. (There was actually a deficit of \$1.8 billion.)

*Dwight D. Eisenhower*: “The first order of business is the elimination of the annual deficit”—Feb. 2, 1953. (There was a deficit for fiscal 1953, fiscal 1954, and fiscal 1955.)

In the last 31 years there have been 25 deficits. As I concluded my column of eight years ago: “Each President began with pious promises of a budget balance, but there were always reasons why this could be done only in some indefinite future and not now. Meanwhile, the national debt keeps mounting and the purchasing power of the dollar keeps shrinking and a Republican budget director is warning against ‘the disturbing effects on the economy’ of spending cuts that are ‘too abrupt.’” Isn’t this where we came in? ❁

## Downgrading Ourselves

November 13, 1961

In addressing an international meeting of economists at Turin, Italy, last September, Karl Brandt, formerly a member of President Eisenhower's Council of Economic Advisers, warned his listeners that:

"This task of undermining the self-assurance and good conscience of the public in the leading Western countries is the easiest part of the Soviet's ideological warfare. . . . The weakening of the Western position is made relatively easy for the Soviets and their sympathizers by all those Western *ex post* anti-colonialists to whom the history of Western civilization is one chain of many centuries of crimes, exploitation, and brutality. . . .

"Nothing could better serve the cause of those who one day promise to bury us, another day threaten to wipe England and France off the map with twenty rockets, and do their utmost to destroy the prestige of the West than the masochistic and morose auditing of nothing but the errors and shortcomings of our history by so many academic professors in Western universities."

### ON WHOSE SIDE GOD?

A perfect example is a speech on Oct. 27 (i.e., in the week between Soviet Russia's explosion of the 30-megaton thermonuclear bomb and its explosion of the 50-megaton bomb) by the Rev. Dr. John C. Bennett, Dean of the Faculty at the Union Theological Seminary:

"It is our temptation to assume that, because our opponents are atheists, God must be on our side and to overlook the extent to which Communism itself is a judgment upon the sins and failures of the middle-class world, upon the Christian world. The very atheism of Communism is a judgment upon the churches which for so long were unconcerned about the victims of the industrial revolution and early capitalism and which have usually been ornaments of the status quo, no matter how unjust it has been."

There are two chief implications here. One is that God may be a Neutralist, or is belatedly punishing the present generation of the Western world for the sins committed by some of its ancestors nearly two centuries ago. I shall leave analysis of this argument to Dr. Bennett's fellow theologians. But his second implication is economic. It is that the Industrial Revolution and early capitalism was a period in which economic conditions became more unjust and more miserable than in the periods preceding.

### MARXIST HISTORY

Dr. Bennett no doubt came by this opinion innocently enough. Under the influence and example of Marx and

Engels, it was the idea popularized by a whole school of nineteenth- and early-twentieth-century historians. But a sober review of the facts shows it to be false. The Industrial Revolution was a period of greatly accelerated economic progress. It was marked both by a great rise in wages and a dramatic increase in population. (England had 8.5 million inhabitants in 1770, 16 million in 1831.) By cheapening goods through mass factory production the Industrial Revolution first made possible consumption of such goods by the masses.

In the light of our present standards many of the conditions of early capitalism seem shockingly bad. But it was precisely the accelerative economic growth that capitalism, factory production, and free markets themselves made possible, which led to the infinitely improved working and living standards of today by which we so harshly judge early capitalism.

I should like to prescribe a short reading course for Dean Bennett: *Human Action*, by Ludwig von Mises, pages 613–619; *Capitalism and the Historians*, edited by F.A. Hayek, and *The Industrial Revolution*, by T.S. Ashton.

What is most "amazing to contemplate" is not (as the Dean insists) "the utterly self-defeating character of the intransigent forms of conservative anti-Communism in this country," but, I suggest, the utter defeatism of the intransigent anti-anti-Communists whose guilt complex keeps supplying propaganda material for the Russian Communists to use against us. It is time our self-styled intellectuals learned and called attention to the truly enormous and inspiring achievements of the West, made possible by its respect for private property and economic freedom. ☸

## Socialistic 'Reforms'

November 20, 1961

I recently received a letter from a prominent Mexican. "The propaganda in Latin America in favor of socialistic measures," he wrote, "goes on and on. The astounding part is that those who make it are not Russians but Americans. Last week it was the turn of your Under Secretary of State, Chester Bowles. In a speech delivered on Oct. 19 before the Mexican-North American Cultural Institute, besides agrarian reform and 'a more just distribution of wealth which *already exists*' [underlined in the official text], he came out in favor of high progressive income taxes and exchange controls. . . .

"What can we do to awaken the American people and to make them realize that their present leaders are delivering them into the hands of their enemies? Except

for the French aristocracy in the eighteenth century, I do not believe history offers a comparable example of a social class collaborating in its own disappearance and destruction. If the United States preaches socialism, there is very little that we [Mexicans] can do here. All your millions will not only be wasted; they will speed the present trend to socialism and the ultimate take-over by Communists."

#### URGING 'REVOLUTION'

Thinking that perhaps my Mexican correspondent was unduly alarmed, I sent for the full text of the Bowles speech. In addition to the remarks he quoted I found:

Allusion to the United States as a "privileged society" and part of "the well-fed and comfortable minority of mankind." Constant advocacy of a "*continuing* revolution," "revolutionary change," "the right of revolution." True, these references were sometimes preceded by the adjective "peaceful." But Latin Americans are not apt to interpret "revolution" in this purely metaphorical way.

Bowles advocated high corporation taxes and a steeply progressive income tax: "Such tax systems are needed to soak up idle profits." He held up the U.S. practice as a shining example: "The corporation tax on annual business earnings above \$25,000 is now set at 52 percent. On top of that is a tax on *personal* income [his italics] that rises rapidly as incomes rise to a top level of 90 percent." Bowles backed this up with a direct quotation from the Punta del Este Declaration which calls for "tax laws which demand more from those who have most, punishing tax evasion severely, and *redistributing the national income in order to benefit those who are most in need.*" (My italics).

#### EXPROPRIATING LAND

Bowles demanded "land reform," and supported this by a direct quotation from the Punta del Este Declaration condemning "unjust structures and systems of land tenure and use." How this is likely to be interpreted in Latin America was illustrated by President Goulart of Brazil, as reported in *The New York Times* of Nov. 5: "He urged constitutional changes to permit agrarian and other reforms. At present the Constitution forbids any take-over of lands without compensation." In other words, he wants to seize lands without compensation.

"I do not see," added Bowles, "why my government or any other capital contributor should be asked for loans or grants to replace runaway indigenous capital that could be kept at home by" exchange controls and similar "curbs." The private capital that has "run away" from Latin America has done so in fear of further galloping inflation or of direct confiscation. Bowles urges that it not be allowed to escape.

Of course the "reforms" recommended by Bowles would frighten off domestic saving and investment, disrupt and demoralize production, move toward socialism, totalitarianism, or chaos—and of course enormously increase the foreign aid burden that the American taxpayer will be asked to assume.

The real reforms are the precise opposite. What the retarded countries need most is political stability, internal peace and order, security of life and property, due process of law, economy, balanced budgets, a halt to inflation, and the maintenance of free markets. The policies that would do most to attract private investment from abroad are precisely those that would encourage saving and investment at home. ☼

## Inflation for Growth?

November 27, 1961

As Lawrence Fertig points out in his new book, *Prosperity through Freedom* (Regnery, \$3.95), there is only one way in which a nation can achieve economic growth. That is by capital accumulation—i.e., "by increased savings and by increased investment in the tools of production." Yet it is precisely the people who most ostentatiously clamor for a speedup in our rate of economic growth who most persistently ignore this truth. They want to get economic growth through inflation. And as Fertig emphasizes not only by reasoning but also by citing the record of postwar Germany and the Rueff plan in France, sound, long-run growth is achieved not by encouraging inflation, but by bringing it to a halt.

The German experience throws a brilliant light on this. In 1951 the U.S. State Department sent a commission of American economists to West Germany to investigate and to make recommendations to that government on fiscal policy. The chairman of the commission was Prof. Alvin W. Hansen of Harvard. Prof. Walter W. Heller, now chairman of President Kennedy's Council of Economic Advisers, joined the commission and is credited with having participated in writing the report. This report was long classified as a secret document. It was not declassified until April of this year.

#### GERMAN 'MIRACLE'

Here are some of its recommendations: (1) That Germany had an "excessive concern for price stability," and tended to "confuse wartime inflation with the normal operation of peacetime credit." (2) That "a rate of interest high enough to stimulate any large volume of personal savings would seriously curtail investment."



(3) That to give special inducement to corporations to increase their investment in new plant and equipment by permitting fast depreciation allowances “was an expenditure of tax funds which would otherwise have been collected by the government.” (4) That “the nostalgic hopes . . . looking toward a revival, of the nineteenth-century role of a capital market are doomed to disappointment.”

Fortunately for Germany and the world, Ludwig Erhard, the German Economics Minister, rejected the recommendations *in toto*. He put a tight lid on any increase in the money supply. He refused to pursue a cheap-money policy. He encouraged saving by a high rate of interest. He permitted rapid depreciation on investment. He restored the capital market. He refused to impose a top income tax rate higher than 50 percent, balanced the budget, encouraged private enterprise, restored incentives. In his own words, he “abolished practically all control for allocation, prices, and wages” and “reintroduced the old rules of a free economy.”

#### GOVERNMENT'S ROLE

The result was “the miracle of German recovery,” a record unequalled in the same period in the entire Western world. Had the Hansen-Heller recommendations been adopted, Germany would have been plunged into another orgy of state planning and inflation. David McCord Wright, comparing the German record with the British record under Labor government, found that British prices under inflation (1948–56) increased 45 percent while German prices *fell* 5 percent. While real wages in Germany more than doubled, British workers got a bare 10 percent increase. Germany's manufactured exports, with lower costs, rose from 7 percent of the world market to more than 15 percent. Its gold and dollar surplus soared, while that of the British declined.

Lawrence Fertig's important and stimulating book covers not only the subject of economic growth but also the whole range of modern economic issues—wages and prices, profits and employment, monetary and fiscal policy, unions, inflation, foreign trade, capitalism, socialism, Communism. It is the people, as Fertig keeps insisting, and not governments, that produce wealth and increase “growth.” All that government can do is to keep the currency honest and strong, to keep markets competitive and free, to maintain law and order and security of life and property, to remove the restrictions it has itself imposed on trade and production—in brief to release the energies of a free people and then *get out of the way*. ❁

## To Preserve the Dollar

December 4, 1961

The world in the last few decades has not been on the gold standard, but on an American dollar standard. Under the International Monetary Fund system, most other countries have fixed official par values for their currencies in terms of the dollar. Relying on our promise and our ability to keep their dollar holdings convertible into gold at \$35 an ounce, foreign central banks have based their own operations on the assumption that the dollar is “as good as gold.” They have used dollars, precisely as they have used gold itself, as part of the reserves on which their own internal credit structures and national currency units are based.

If anything should happen to the integrity of the dollar—if we should find ourselves obliged to pay out gold until our reserves were exhausted, or if, to avoid this, we should either suspend exports of gold or devalue the dollar, we would not only destroy the international status of the dollar and irreparably impair our own prestige, both political and economic, but also we would do immeasurable damage to world confidence. As Secretary Dillon has admitted: “The dollar, as the world's basic reserve currency, is the very foundation of international trade and commerce.”

#### PLEDGES NOT ENOUGH

Yet, grave as this danger is today, it is being treated in Washington with levity. President Kennedy did, indeed, take the first necessary step when he gave assurance in his first month in office that “the dollar must be protected . . . in its present value” and went on to pledge more specifically that he would take no action “to increase the dollar price of gold from \$35 an ounce” or “to impose exchange controls.” But the dollar cannot be defended merely by uttering the right phrases. These must be followed by actions and policies which will give the world assurance that such pledges can and will be kept.

The policies Mr. Kennedy has been following, far from giving such assurance, are calculated to give rise to the deepest misgivings. The President and his aides have dealt, at best, only with short-term expedients or surface symptoms. They have attempted to deal directly with the balance-of-payments problem by reducing the duty-free allowance of returning American travelers from \$500 to \$100 and by ordering our forces in West Germany to buy their coal from the U.S. Such measures are trivial; they do nothing to remedy the basic situation. To the extent that we discourage imports we discourage exports, by depriving foreign countries of that amount of dollar exchange with which to buy our goods.



## HALT THE INFLATION

The Administration made efforts at Vienna in September to solve our alleged “balance-of-payments” problem by increasing the lending power of the IMF so that we could borrow more. But as M.W. Holtrop of the Nederlandsche Bank pointed out, there is no solution “in just feeding the excess reserves of the surplus countries back into the international circuit, so as to enable the deficit countries to continually finance their deficits. This would only create the perfect machine for perpetual inflation.” And as the First National City Bank of New York asks: “Would not massive drawings on the fund be interpreted as an admission that the United States could not settle its deficit by selling gold? Should a banker seek to negotiate borrowings from depositors?”

The blunt truth is that our balance-of-payments deficit is simply the consequence of our internal inflation. This raises our prices to discourage exports at the same time as it increases the dollars with which we buy imports. No matter what solution we ultimately adopt for our dollar problem, the first and indispensable step is to *halt the inflation*. This calls for remedies unpalatable in Washington, which continues to be hypnotized by the superstition that inflation is necessary for “a high rate of growth.” We can still prevent a deficit of \$7 billion in the current fiscal year by starting immediately to slash into our fantastic \$89 billion spending program. And we can signalize a halt in our cheap-money policy by a simple increase in our rediscount rate.

Or must Washington wait until after disaster has happened before it can be brought to reexamine its ideology? ❁

## Profits Mean Jobs

December 11, 1961

In the socialist attacks on the capitalist system, profits are the chief villain. They are portrayed as monopolistic, unfair, excessive. They are commonly thought to be achieved either by adding to prices or by squeezing down wages. The profits of the few are pictured as the cause of the poverty of the masses.

The truth is the exact opposite. In a competitive economy the highest profit margins go to the firms that through efficiency are most successful in reducing costs of production. Thus constant striving for maximization of profit *reduces* prices by reducing costs. The prohibition of profit would return the world to poverty.

The social function of profit and loss is (1) to maximize incentives for production; (2) to balance production among thousands of different commodities and services so as to supply them in the proportions most wanted by consumers; (3) to stimulate incessant improvements in efficiency, to reduce costs and so prices; and (4) to put capital and the direction of production into the hands of those who have shown themselves best able to serve the consumers.

In a massive, thorough, and desperately needed book, *Understanding Profits* (Van Nostrand, \$13.75), the late Claude Robinson argues the case for the profit-and-loss system and endeavors to catch up with age-old misconceptions and slanders. His book is especially strong on the statistical side. Its appendix contains a hundred pages of tables analyzing the profits over long periods not only of industries but of every big corporation.

## WHO GETS WHAT?

Robinson is concerned particularly to show how the extent of profit is commonly exaggerated. Thus he points out that in the ten years 1949 through 1958 the average profit of all U.S. manufacturing corporations was only 3.9 percent on total sales and only 8.6 percent on investment (in spite of inflation during the period). The apparel trades and meat packers made a profit of less than 1 percent on sales during the ten-year period.

As to the division of corporation income between employees and owners, he shows that for the 22-year period 1938–1959 employees got 84 cents out of every dollar available for both groups, and the stockholders only 16 cents. This 16 cents was in turn divided into 7 cents reinvested in the business and 9 cents paid out in dividends. Thus, year by year, the workers in the corporations got more than five times as much as was *available* for the owners, and more than nine times as much as the latter actually *received*. High corporation income, in short, is no less important to the workers than to the owners.

When a book gives so much information, it seems ungrateful to complain that it does not give more. But I wish it contained one table comparing corporate profits, employment, and wages year by year since, say, 1929. This would have shown how profits, employment, and wages go up and down *together*.

## CREATING ABUNDANCE

Part of the function of profits is to direct production into the right products—i.e., those most wanted by consumers. In the ten-year period 1950 through 1959 leading drug companies on the average made 10.9 percent profit on sales and 20.5 percent on investment. This

compared with an average of only 5.8 percent on sales and 12.6 percent on investment for leading companies in manufacturing. Such a result will be deplored only by those who fail to recognize its consequences. In 1948 the drug industry spent \$30 million on research; in 1959 it devoted \$170 million to research. Result? Not only the discovery of a multitude of drugs that prolong life and relieve suffering and pain, but also a sensational drop in drug prices. Penicillin was sold at \$100 for 100,000 units in 1943 and for 22 cents in 1956. Cortone was put on the market at \$200 a gram in 1949, and had been cut to \$2 by 1957.

The supreme folly is to believe that politicians “protect” the consumer when they set an arbitrary ceiling on prices or profits. It is precisely high profits that stimulate the maximum investment, competition, and research to increase the output and bring down the costs of the things most wanted. It is the quest for high profits that brings abundance and low prices. ❁

## Growth Means Capital

December 18, 1961

The chief slogan of the self-styled liberals, once Full Employment, is now Economic Growth. Yet it is precisely the people who are most insistent on “a higher rate of economic growth” who exhibit the least understanding of how to achieve it. Nearly always they favor more inflation and more socialism—spending, deficits, controls, hostility to profits, punitive taxation—in brief, all the things that discourage true economic growth.

The central requirement for a continuous improvement in economic conditions is a continuous increase in the amount of real capital per head of the population—in other words, a constant increase and improvement in the plants, equipment, machines that increase productivity. Economic growth is the growth of capital formation. It is because the American economy puts more and better tools behind each worker that American wages and living standards are the highest in the world.

Yet growth in capital formation does not occur automatically. In recent decades it has been slowing down. This is the conclusion of a monumental study carried on since 1950 under the direction of Simon Kuznets for the National Bureau of Economic Research. His *Capital in the American Economy: Its Formation and Financing* is the seventh and final volume of the study.

### DECLINE IN SAVINGS

Here are some of the significant findings. There is no support whatever for the thesis, so popular in the 1930s,

that the American economy faces economic stagnation—that investment opportunities are drying up. On the contrary, the outlets for capital use have multiplied faster than the rate at which current product is saved. In the decades ahead “the supply of voluntary savings may not be adequate.”

*Gross* capital formation (which includes what corporations set aside for depreciation and replacement) has been comparatively constant over 85 years as a percentage of gross national product. It has declined from 22.6 percent (at constant prices) in 1869–88 to 17.6 percent in 1946–55. Corporations supply about two-thirds of *gross* capital formation.

*Net* capital formation, however, or the amount of new *additions* to the capital stock, has shown a distinct downward trend as a percentage of national income. For volumes in constant prices, the share declined from 14.6 percent in 1869–88, to 11.2 percent in 1909–28, and to 7.0 percent in 1946–55. For these *additions* to the capital stock, the relationship between corporate and personal contributions is reversed. Personal savings account for more than two-thirds of *net* capital formation.

Now if, as Dr. Kuznets declares, “capital formation is . . . our primary interest because it is essential to economic productivity and economic growth,” and if, “on a countrywide scale it represents the real savings of the nation,” we come to the problem of why real savings, as a percentage of income, have been declining.

### ROLE OF HIGH TAXES

Here, I think, two factors can be emphasized—inflation and taxation. In periods of inflation, saving is discouraged because of the declining value of money. But a more constant factor is taxation. When the government takes 52 percent of corporate income, and taxes higher personal incomes at rates up to 91 percent, it soaks up and uses for current consumption or dissaving (particularly with deficit financing) precisely the funds otherwise most likely to go into saving and new investment.

If we really want a high rate of capital formation and economic growth, therefore, we will completely reform our Federal spending and tax program. We will allow rapid depreciation allowances, knowing that these encourage investment (and in the long run even higher government revenues). We will reduce the corporate tax rate and the extent of double taxation of corporate dividends. And we will slash progressive income-tax rates—especially the confiscatory rates above 50 percent.

If our primary aim is *not* to improve the productivity and real wages of labor, however, but to continue a purely vindictive policy of “soaking the rich,” we will hold fast to our present confiscatory tax rates. ❁

## Remove Trade Barriers

December 25, 1961

So many strands have become twisted and tangled together in our discussion of foreign-trade policy that a first task is to unravel a few for separate consideration.

1—The President deserves the fullest support in his advocacy of greater freedom of trade. But we must be clear concerning precisely why freer trade is desirable. The chief reason is that free trade maximizes the economies and efficiencies of world production. When each country devotes itself to producing what it can produce better and cheaper than any other, world production and consumer satisfactions are maximized.

2—From the standpoint of each country, the only direct advantage of foreign trade consists in the imports. It is through these that a country obtains the things it either could not produce at all, or produce only at a greater cost than the cost of what it exports to pay for them. As John Stuart Mill insisted, it is what a country obtains from foreign trade, not what it parts with, that constitutes the real gain to it. At points in his speech to the NAM, Mr. Kennedy recognized this: “We need those imports to give our consumers a wide choice of goods at competitive prices.” But more often he talked as if the real gain were in greater exports. Thus when he quoted favorably the “British” (unfortunately also the Hitler) slogan “Export or Die,” he forgot its basic meaning. The meaning was that unless a manufacturing country exported enough *to pay* for its *necessary imports of foodstuffs* and raw materials, it would die.

3—In the long run, the number of “jobs” is irrelevant to the height of trade barriers. The real difference is that when trade barriers are high production is less efficient and real wages are lower. If lower trade barriers give more jobs in export industries, they may take away a corresponding number of jobs in industries hurt by imports. It is a sudden raising or lowering of tariffs that disrupts the balance of industries and creates unemployment. As changes either way are unsettling, they should be infrequent and gradual.

4—Sweeping and sudden tariff changes are therefore to be avoided. More study should be given to

gradualism. Even if it is decided, for example, that an ad valorem duty of 60 percent on some import ought to be completely abolished, it might be better to reduce it by 1 percentage point a month over five years than with an ax. The worst way of making such an adjustment is by subsidies to home industry. These would breed discrimination, favoritism, and corruption, and tend to be self-perpetuating. They would nullify the very purpose of lower tariffs.

5—Today tariff levels are among the least rather than the most important barriers to international trade. One of the worst barriers is the import quota system, as on petroleum and sugar. Import quotas are discriminatory, arbitrary, inflexible, and an instrument of political favoritism. A first step should be to abolish them and substitute a non-discriminatory tariff, which would at least permit price and efficiency competition among individual importers and exporters.

6—If the Administration favors freer foreign trade, its policy must be consistent. It must abandon such efforts to discourage imports as the drastic reduction of duty-free tourists allowances. It must abandon its short-sighted discouragement of American foreign investment, or its attempt to force such investment into the areas where *it* thinks it should go rather than where investors want to put it. It must abandon its efforts to dump our agricultural “surpluses” (created by government policy) onto foreign markets. It must stop subsidizing raw cotton exports and penalizing the American textile industry.

7—Finally, it should halt the inflation which is making it increasingly difficult for American manufacturers to compete abroad. It must change the legal and political setup that encourages excessive wage rises. Mr. Kennedy, in his speech to the NAM, promised to “stress” the need for wage restraint in addressing the AFL-CIO, but merely expressed a “hope” that was dashed the next day by his Secretary of Labor’s insistence that there was “plenty of room” for further wage increases and that the Administration did not “propose in any way to restrict the ability of collective bargaining” to get them. ☸

1962





## Common Market and Us

January 1, 1962

Last week I discussed seven basic issues and principles involved in foreign-trade policy, but never got to the complicated problem of the European Common Market and what our relations with it ought to be.

At the heart of that problem is the difficulty of knowing whether the Common Market will prove in the long run to be a step toward free trade or a step toward increased protection. It is a step toward freer trade among its six members—France, West Germany, Italy, Belgium, Luxembourg, and the Netherlands—but it remains a protectionist area against the rest of the world. Even internally it is not yet certain whether its net effect will be to encourage a free economy or collectivist controls. So far as agricultural products are concerned, subsidies, tariffs, and quotas on the part of member nations are as entrenched as ever. Industrial products, such as coal and steel, are on a cartel and quota basis. And unless the Six either adopt a common currency, or return individually to a gold basis, free trade among them will not in the long run be feasible.

### DISCRIMINATION

In seeking free trade within the area, but continued discrimination against non-members, the Common Market suffers from an internal contradiction. It says to the Italian automobile manufacturer: We will continue to protect you against the competition of the Ford, but you must now accept the competition of the Volkswagen, because the Germans are now One of Us. We will let you buy raw materials from Germany if you can get them cheaper there, but we will not let you buy them from the U.S. because Americans are Foreigners. And the Common Market likewise says to the Italian consumer: To give you a wider range of choice and price, we will let you buy a Volkswagen from Germany; but we will not let you buy a Falcon or a Cadillac, unless you pay a stiff penalty tariff.

In brief, the Common Market discriminates against American products. This is what it was intended to do. Yet our own officials have from the beginning actively encouraged the Common Market. They have even gratuitously interfered to encourage the Common Market as against the European Free Trade Association, or Outer Seven, though the latter worked on the much sounder principle of lowering their trade barriers vis-à-vis each other without requiring any member to raise its tariffs against non-member nations.

### BARGAINING FALLACY

As of now, the Common Market has triumphed over the Free Trade Area, not because it is nearer to free trade, but because it is farther from it. It is precisely its discrimination as a unit against non-members that gives it the bargaining power to force others to negotiate to “get in under the tent.” If Britain joins, and others of the Outer Seven follow suit, the chief country against which it will discriminate will be the United States. And if we joined, against whom would the common tariff wall be built? Katanga?

The President has not suggested that we join the Common Market. He has correctly insisted that we adhere to “our traditional most-favored-nation policy.” This means that we would not discriminate against any nation, but grant to every one as free an entrance or as low a duty for specific products as we grant to the “most favored.” Surely this is the policy that we ought to follow, not only vis-à-vis the Atlantic Community, but the whole non-Communist world.

But with such a policy, nation-to-nation or region-to-region bargaining would be not only unnecessary but inconsistent. Each nation could act by itself, realizing that it helps its own consumers and even the great bulk of its own producers by reducing trade barriers even if other countries refuse to do likewise.

Today this may sound like a counsel of perfection. The Common Market is a fact; and perhaps the most effective way of dealing with it, as of now, is through reciprocal bargaining. But let us not forget that such reciprocal bargaining rests on the protectionist fallacy that reduction of barriers to imports is a “sacrifice” or “concession” justified only by the reciprocal “concession” another country makes in favor of our exports to it. ☼

## Inflation Must End

January 8, 1962

Those of us who, for the past fifteen years or more, have been warning against inflationary policies, have found ourselves doing it with little help on net balance from the academic community, particularly that part of it clustered around Cambridge, Mass. Such Harvard faculty names as Seymour Harris, Alvin Hansen, J.K. Galbraith, and the late Sumner Slichter have been associated, if not with direct advocacy of inflation, at least with advocacy of such inflationary policies as continuous credit expansion, cheap money, increased government spending, and unbalanced budgets.

Now, out of Harvard itself, comes a powerful voice that not only warns against inflation, but correctly

analyzes its causes and courageously recommends its cures. Gottfried Haberler is not only a Harvard professor; he is a former president of the International Economic Association and will be president of the American Economic Association. Because of his prestige and the power of his argument, his 85-page pamphlet, *Inflation: Its Causes and Cures* (Revised and enlarged edition, American Enterprise Association, Washington, \$1) may well mark a turn of at least the academic tide of thought on the subject.

### PAYMENTS CRISIS

Because of the deterioration in the U.S. trade and payments position the tone of the revised edition is urgent:

"In view of the changed competitive position the U.S. can no longer afford even a 'little' inflation without losing gold. Moreover, disinflation or at least holding the pace of inflation below that of our principal competitors is the main prerequisite for a correction of the imbalance.

"Here is not the place to discuss other measures that could be taken to improve the balance—elimination of discrimination against dollar exports, larger contributions by Europe for mutual defense and for economic aid to underdeveloped countries, tied loans, and so on. The effect on the balance of payments of all these measures combined will probably be insufficient to eliminate the deficit and, at any rate, it could be easily wiped out by loose financial policies. The position of the U.S. as the world's foremost banker and of the dollar as the world's principal reserve currency greatly increases our responsibilities. At the same time, it excludes easy solutions which would be open to others. . . .

"The U.S. cannot tamper with the gold value of the dollar without committing a crass breach of the confidence of all those who have entrusted us with keeping their international reserves and without provoking an international financial crisis which would greatly weaken American leadership in the free world. . . .

"The conclusion is that, from now on not only considerations of international stability and sustained growth, but also the international position of the U.S. imperatively require that inflation be stopped."

### TO CURB WAGE DEMANDS

It is possible to cavil at a few aspects of Haberler's study. But any shortcomings are far overbalanced by enormous merits. Several aspects of the American inflation in recent years get a more thorough analysis than they have received anywhere else. And Haberler is emphatic on the essentials: "Let us start from the basic fact that there is no record in the economic history of the whole world, anywhere or at any time, of a serious and prolonged inflation which has not been accompanied and

made possible, if not directly caused by a large increase in the quantity of money."

Finally, he recognizes the necessity of curbing excessive union wage demands if inflation is ever to be halted. And he points out that this can be done by legal reforms that in no way infringe liberties, but merely restore a more balanced power equilibrium between the parties in wage bargains, and eliminate violence and intimidation. More basic than legal reform would be a change in public opinion. "Aroused public opinion could force the government in its executive as well as in its legislative branch to pick up some courage, instead of maintaining a studious neutrality in wage bargaining, and issuing platitudinous appeals to everybody to behave, or outrightly capitulating to striking unions and bringing pressure on employers to capitulate." ❁

## Are We Anti-Capitalist?

January 15, 1962

Two weeks ago my colleague Raymond Moley pointed to the strange fact that our government was supporting the action of the U.N. in systematically destroying, among other things, the properties of the Union Minière, which would have been the major source of supply for the entire Congo. "Since that company represents capitalism," he continued, "it is easy to see why the Soviet so eagerly supported the U.N. resolution which precipitated the war." But how explain our own government's action? "Could not the President and his many advisers understand the consequences and also the inconsistency of ruthlessly destroying the Congo's economic viability and then spending billions to restore it through foreign aid?"

This strange attitude was revealed afresh in the attack by Carl T. Rowan, Deputy Assistant Secretary of State for Public Affairs, on Dec. 27:

"Out of Katanga's rich veins, Union Minière was producing 8 percent of the world's copper, 60 percent of its cobalt, and many other minerals. Union Minière was a classic example of the profitable side of colonialism. Despite all the Congo's troubles, this Belgian-controlled firm had net profits of \$47 million in 1960. . . . Union Minière pays about 80 percent of the tax revenues of Katanga. . . . Now isn't it natural that those with financial interests in Union Minière would rather see Katanga as an easily controlled 'separate nation' than as part of a larger Congo nation whose government might not be as friendly as Mr. Tshombe and his associates? . . . Much of Mr. Tshombe's most vocal support arises not so much from the fact that he

is 'anti-Communist' as the fact that he is pro-Union Minière."

### WHAT PROFITS DO

This remarkable statement admits that the Union Minière, formed in 1906, has become the economic backbone of Katanga, and is vital even in the world economy. Yet Rowan is sarcastic because the company has until recently earned a profit. If it had not been that profitable, however, it could not have supplied 80 percent of the tax revenues of Katanga, and it could not have employed 21,000 people (equivalent to the whole adult male population of Katanga's 95,000 inhabitants).

Rowan's statement seems to imply that if a foreign-owned company is profitable, all the benefits go to the foreign owners. This is a fallacy we are accustomed to find among socialists, Communists, and xenophobes. But it is strange to see it getting implied support from a member of the State Department of the world's greatest creditor nation, with huge investments all over the globe. For this fallacy is always the excuse offered for the expropriation and nationalization of foreign-owned companies. (Rowan did admit at one point that "the Congo needs much that Union Minière can give.")

### HOW TO RETARD GROWTH

Rowan implies that it is a point *against* Tshombe that he is not only anti-Communist but pro-capitalist. Rowan seems to expect the same thing that the Union Minière expects that the government of "a larger Congo nation . . . might not be as friendly as Mr. Tshombe"—i.e., that it might levy still heavier taxes (already some \$50 million a year), and perhaps expropriate and nationalize the properties. But Rowan talks as if this would be a very desirable thing from the American point of view.

The Rowan statement seems to be just one more indication of a strange anti-capitalist bias that now seems to run through our whole foreign economic policy. This is reflected in the Administration's proposals for punitive taxation of American investment in Europe; its efforts to force American investments to go, not to the countries where the owners of the funds want to put them, but to the countries where our bureaucrats think they should go; its deliberate encouragement, in Latin America, of more government planning, more drastic corporate and income taxation, more "land reform" (i.e., expropriation and division of big private land holdings).

It need hardly be pointed out that all these policies must retard, not encourage, sound economic growth in underdeveloped countries, and must increase the burden on the American taxpayer for foreign aid. ❁

## On Doing Nothing

January 22, 1962

*So all those who say that there's nothing left to be done, that we should rest on our laurels, that the function of the national . . . government is to sit and lie at anchor are wholly wrong and we do not propose to follow their advice."*

President Kennedy at Columbus, Ohio, Jan. 6

Who are these people who say that there's nothing left to be done? I have never met one. Are there people who actually believe that the 12,437,668 civilian employees on the Federal payroll should sit back and do nothing because there is nothing to do? Rightly or wrongly, the overwhelming majority of Americans have acquiesced with only minor reservations in the enormous proliferation of Federal programs and powers that has developed since the first and second world wars. A majority have in fact accepted the 2,133 different functioning agencies, bureaus, departments, and divisions found by the Hoover commission even in the Federal government of 1954.

Some Americans, confronting Federal expenditures of \$89 billion in the current fiscal year and some \$94 billion in the 1963 fiscal year, may look back wistfully to 1955, when such expenditures were "only" \$64.5 billion. But no one dares to dream of a return to the \$4.6 billion level of 1932, when candidate F.D. Roosevelt was demanding drastic economies.

### WHO SHOULD DO IT?

Mr. Kennedy is, in fact, attributing an extreme *laissez-faire* and do-nothing philosophy not only to everybody who wants to cut back a little on some of the thousands of existing Federal programs, but to everybody who thinks maybe the Federal government is sufficiently overgrown and over expanded and ought to try to straighten out the messes in, say, foreign aid and farm subsidies, before taking on still more programs.

The assumption implicit in the President's statements seems to be that if any "unfilled need" can be shown to exist anywhere, it is the duty of the Federal government to fill it; and if there is anything that ought to be done in any field, it is the Federal government that should do it. And so he wants it to pay the medical bills of the aged, or the tuition of needy college students, or to cure mental retardation, or to solve any other problem. It is because such assumptions have now become perennial that practically every new Congress enacts more than a thousand new laws.

Yet the truth is that the proliferation of new Federal programs, with their corresponding expenditures, does



not on net balance meet new needs. Whatever the government gives to B it must take from A. It taxes Peter to subsidize Paul. It transfers part of the earnings of some people to other people. Instead of allowing those who have earned money to spend it on their own wants or needs, the bureaucrats seize the money to be spent more “wisely,” or on other people’s real or supposed wants or needs. The politicians may spend the tax money on real collective needs, or in the directions designed to influence the most votes.

### THAT ‘PUBLIC’ SECTOR

The process has semantically come to be known as squeezing the “private” sector (by implication selfish) to expand the “public” sector (by implication benevolent). It would be more accurate to say that the government forces a relatively shrinking free-enterprise sector to subsidize an expanding socialized sector.

This constant expansion of the Federal government does much more than merely transfer income from one set of pockets to another. It abridges the liberties of the individual. It feeds the growth of bureaucracy. It reduces the incentives to production of those who earn money and reduces the incentives to self-help of those who get the increasing Federal aid.

The heavy personal income and corporate taxes soak up precisely the funds that would otherwise have been devoted to savings, to capital accumulation, to the creation of new equipment. The final effect, therefore, of increasing Federal programs and Federal spending must be the opposite of what Mr. Kennedy hopes for. Even if they do not bring on further inflation and imperil the dollar, they must tend to slow down the rate of economic growth, and the rate of increase in real wages and in standards of living. ❀

## ‘Power to Lay Duties’

January 29, 1962

In his State of the Union Message the President asked Congress for two major delegations of power. One concerned its constitutional power “to levy and collect taxes,” the other its power to lay “duties.”

“We need, first,” he declared, “Presidential stand-by authority subject to congressional veto to adjust personal income-tax rates downward within a specified range and time.” There are weighty reasons, both constitutional and economic, why Congress should refuse to delegate this power. Congress has already, through delegation or default, lost too many powers to

the Presidency. The peacetime power of that office is already swollen beyond parallel.

The chief economic assumption behind the President’s request for stand-by powers over income-tax rates—that they must be quickly lowered “to slow down an economic decline before it has dragged us all down”—is fashionable but false. This assumes that the sure cure for recession or unemployment is a budget deficit. A budget deficit is sure to bring on inflation, but whether it slows down a decline or reduces unemployment will depend upon what happens to wage rates and a score of other factors. If inflation through bigger deficits *were* a remedy for recession, there would always be time for the President to send an urgent message to Congress or to call a special session. If Congress is to be asked to delegate powers on the assumption that it is incapable of acting in time, it could more logically be asked to delegate to the President its constitutional power to declare war.

### FOR A NEW SAFEGUARD

Constitutional objections to the transfer of taxing power apply just as much in principle to transfer of power over tariffs. Economically, however, the President is here on firmer ground. Even constitutionally there are important mitigating considerations. Congress has already been delegating such powers, under successive reciprocal-trade acts, for 28 years. There are practical reasons for this. The setting of tariff rates, item by item, involves infinite detail. Before the era of reciprocal-trade acts the final set of schedules was the result of unconscionable logrolling among congressmen, each haggling for the industries in his district. Congress is of course utterly unequipped to bargain separately with each foreign country or trading unit.

There are strong precedents and practical reasons, therefore, why Congress should continue to grant the President discretionary reciprocal trading powers. But because the President’s request goes much beyond the powers granted in the past, Congress would be justified in surrounding such a delegation of power with additional safeguards. The most important of these was suggested by the President himself in his request for discretionary power over income tax rates. Delegation of tariff bargaining powers should be “subject to Congressional veto.”

### ‘RECIPROCITY’

How would this be practically possible? Congress could provide that every trade agreement the Executive power negotiated should be submitted to it before going into effect. It could agree in the new law to accept or reject such an agreement *in toto*, without trying to amend it in detail. (Though if it returned an agreement

unratified it might indicate what changes *would* make it acceptable.) And it could provide further that, if it failed to take any action either way within 30 or 60 days, the agreement would automatically go into effect. Thus Congress, without obstructive delays, could force the American bargainers to keep constantly in mind the overall acceptability to Congress of each agreement.

It remains to be said that the method of reciprocal-tariff bargaining, though we have followed it for the last 28 years, is dubious in principle. It rests at bottom on the protectionist assumption by each party to the bargaining that though exports are good for a country, imports are bad for it. Barriers to imports are therefore lowered only as a “concession” in return for a reciprocal “concession.” Hence there is an incentive to each country to boost its tariffs high in the first place so that it may have more to concede. ☸

## Notes on the Budget

February 5, 1962

**Is It Balanced?** The President estimates that the Federal government will spend \$92.5 billion in the fiscal year 1963, and will take in revenues of \$93 billion, leaving a surplus of \$463 million. This would be the first surplus in three years and the second in six. But the forecast is based on a series of the most optimistic assumptions. Revenue forecasts, for example, are based on the expectation of unparalleled prosperity. With no important net change in tax rates, revenues are counted upon to jump from \$82.1 billion in fiscal 1962 to \$93 billion in fiscal 1963. If revenues did not increase, the predicted surplus of half a billion would become a deficit of \$10.4 billion.

**How Reliable?** In the light of the past record, how much confidence can we place in the new estimates? It is ironic to recall that for the fiscal year 1959, which ended with a deficit of \$12.4 billion, Eisenhower originally estimated a surplus of nearly half a billion, almost exactly what Mr. Kennedy now estimates for 1963. But in 1959 expenditures turned out to be \$6.8 billion more than the estimate, and receipts \$6.1 billion less. Eisenhower originally estimated a surplus for the current fiscal year of \$1.5 billion. Last March Mr. Kennedy estimated instead a deficit of \$2.8 billion. In July this was raised to \$5.3 billion. It is now estimated at \$7 billion—with the year only a little more than half over. If an estimated deficit is raised a billion dollars or so every two or three months, what confidence can we have in a paper-thin surplus forecast seventeen months ahead?

**Why So Big?** The spending estimates for fiscal 1963 are the highest on record in peacetime—\$11 billion higher than in 1961 and \$28 billion higher than in 1955. The taxes to support such spending must undermine productive incentives and siphon off the funds for investment. Sentences in the President’s message give the impression that the rise in Federal spending is almost entirely caused by increased costs of defense. But even with the heavy increase in proposed defense spending to \$52.7 billion, more than half of our total spending of \$114.8 billion (when we count social security and similar payments) is still on nondefense and welfare items. Even when we confine ourselves to the regular budget, we find that compared with the last completed year, 1961, though projected national defense expenditures have increased \$5.2 billion, nondefense and other expenditures have increased \$5.8 billion. Nondefense expenditures of \$39.8 billion projected for fiscal 1963 are almost double the \$20.9 billion nondefense expenditures in 1954.

**More ‘Needs’ Met?** It is a fallacy to suppose that the enormous new budget enables the American people to “meet more needs” on net balance than before. All it does is to transfer expenditures from the free enterprise sector of the economy to the socialized sector, from the voluntary sector to the compulsory sector. The government can give nothing to Paul that it does not take from Peter. Everybody is forced to pay for somebody else’s education or illness. As Bastiat put it more than a century ago: “Government is the great fiction through which everybody tries to live at the expense of everybody else.”

**Inflation Threat:** A few months ago Mr. Kennedy gave his support to the theory that an annually balanced budget was unnecessary; all that was needed was a “balance over the years of the business cycle.” But even this theory involved the implicit assumption that if, say, we ran deficits of \$7 billion to \$12 billion in our bad years, we would have to run equally huge surpluses in our good years. Now Mr. Kennedy’s Budget Message rests explicitly on the theory that though we need heavy deficits to turn the business cycle “from recession to recovery,” even a budget balance at any time, let alone an actual surplus, may endanger prosperity, and that the President needs discretionary stand-by powers to cut taxes or increase spending to cure unemployment.

This theory is very fashionable but quite fallacious. Not merely the new budget itself, but even more the new explicit budget philosophy behind it, must increase the threat and fear of inflation and undermine confidence in the American dollar. ☸

## Growth by Rhetoric?

February 12, 1962

Throughout the *Economic Report of the President* and his advisers run a multitude of supremely confident assumptions. They know just where the GNP is going to go. They know just how much economic growth we ought to have every year and just how to get it. They know the “guideposts” and formulas for fixing wages and prices. They know just what to do if things start to turn for the worse. All that is necessary is for Congress to surrender some of its constitutional powers and responsibilities *now* and turn them over to the President to use in an “emergency.”

“As 1961 ended, actual output was still \$25 billion to \$30 billion short of potential.” If we attained our “maximum,” GNP in 1963 would reach “approximately \$600 billion.” “We should not settle for less” than a growth rate of 4½ percent a year. In fact, in November, together with our nineteen fellow members, “we pledged ourselves to adopt national and international policies aimed at increasing the combined output of the Atlantic Community by 50 percent between 1960 and 1970.” Well, as Shakespeare put it: “If to do were easy as to know what were good to do, chapels had been churches, and poor men’s cottages princes’ palaces.”

### NEED FOR INVESTMENT

Economic growth depends on one thing: The volume of new investment—the amount of capital put into new machinery, plant, and equipment to increase productivity. In all the Administration proposals outlined in the Economic Report only one—a modest investment tax credit and revised depreciation allowance—is directly calculated to encourage increased private investment. Nearly all the other proposals would discourage it. They would increase government spending, increase deficits, and increase the tremendous burden of corporate and personal income taxes that already discourage and reduce our rate of economic growth. For they reduce incentives at the same time as they siphon off for non-productive government spending the funds that would otherwise have gone into new investment.

The main assumption behind the Economic Report, in brief, is that the cure for unemployment is inflation, if you can only get enough of it. On this assumption the President asks for emergency stand-by power (1) to cut income taxes by as much as \$10 billion a year and (2) to increase spending on public works by \$2 billion a year. He also asks for longer and bigger unemployment benefit payments.

### DEFICITS VS. JOBS

The assumption is that huge deficits are always a sure cure for unemployment. Nowhere in the report is there any reference to our experience in the ten years from 1931 to 1940 inclusive, when uninterrupted deficits averaging 3.6 percent of the gross national product (equivalent to \$18.7 billion a year at present GNP levels) were accompanied by average annual unemployment of 18.6 percent of the total working force (equal then to 10 million and now to more than 13 million unemployed). Nor is there the slightest hint that unemployment may be the result of excessive wage rates or that anything effective should be done to mitigate union demands. Nor is there the slightest suspicion that higher and longer unemployment benefits might directly and indirectly *increase* unemployment.

Even if there were reason to think that the President’s proposed spending and taxing policies might reduce unemployment without increasing inflation, there would be no reason for Congress’s granting him stand-by powers. The President could always send an urgent message or call a special session and allow Congress to use its own judgment in the light of conditions at the time.

In brief, the President’s proposed policies seem likely to bring about precisely the opposite of the goals he wishes to achieve. They would slow down economic growth by reducing incentives to work and save and invest. They might increase rather than reduce unemployment. They would almost certainly increase inflation and thereby (together with his light-hearted suggestion that our 25 percent gold-reserve requirement might be repealed) undermine that confidence in the dollar which he is so eager to preserve. ❁

## More Planned Chaos

February 19, 1962

President Kennedy’s call for a Congressional investigation of the government’s war-emergency stockpile program is gratifying. Such an investigation, in fact, is long overdue. Let us hope that it will not deteriorate into mere personal and partisan charges, but will confine itself mainly to essentials and basic principles.

If the investigation is partisan, neither party is likely to derive much credit from it. The program was started in 1939, under Roosevelt, resumed by Truman in 1946, and expanded by Eisenhower. In fact, it is astonishing that Mr. Kennedy was “astonished” to find that the nation’s strategic stockpile now contains \$7.7 billion worth of materials. This does not differ much from



the situation a year ago, when he came into office. And the figures have been published monthly for more than two years by the Byrd Joint Committee on Reduction of Nonessential Federal Expenditures.

Mr. Kennedy declared that the materials the government is holding exceed the nation's "emergency requirements as presently determined by nearly \$3.4 billion" even though these requirements are based on the highly improbable assumption that a (presumably nuclear) war today would last as long as three years. But this overbuying has also long been common knowledge.

#### HANDOUT TO INDUSTRY

Five years ago official estimates indicated that the U.S. had enough tungsten aboveground to last for six years at the peak wartime rate of consumption. Even a tungsten producer, Philip M. McKenna, pointed this out, and opposed Federal subsidies to domestic tungsten producers as neither necessary nor desirable. The government purchases of lead and zinc were also widely recognized five years ago as nothing more than a hand-out to industry.

The stockpiling program demonstrates once more that when the government embarks on a commodity buying, subsidizing, or "stabilizing" program even for "essential" purposes, political pressures and momentums develop that carry it far beyond its original or any rational purpose. It now includes some 76 commodities. The government dare not reverse its program, and fears even to halt it, lest it demoralize the very markets and producers it was trying to help.

In the press conference in which Mr. Kennedy called for an investigation of stockpiling, he only incidentally mentioned the most costly stockpiling program of them all, that of agricultural commodities. The Byrd committee figures show that on Nov. 30 the total cost value of stockpiles under the General Services Administration was \$8.7 billion, but the agricultural price support program added \$5.4 billion more, bringing the total above \$14 billion. For the fiscal year 1961, *annual storage costs* of agricultural stockpiles were \$460 million, out of a total \$475 million.

#### 'AID' MEANS CONTROLS

Ironically, on the same day as the President publicly worried about the strategic stockpiles, he submitted to Congress a new agricultural support program. True, he argued that this would reduce surpluses. But his argument rested on the assumption that in return for their subsidies the farmers will accept the most complicated and drastic controls, not only over acreage but over marketing quotas, to which they have ever been subjected. The alternative with which they are faced is that if they refuse to accept such controls not only will

all price supports be dropped but also the government will dump its holdings of crops on the open market.

The present predicament of these programs emphasizes once more the danger to producers from accepting government "aid" and subsidies. Always, eventually, these lead to governmental control and dictation. Let us hope that the colleges and the score of other present applicants for Federal funds can learn this elementary lesson.

Meanwhile, it is worth pointing out that government "stabilizing" programs are always, in the long run, *unstabilizing* programs. The President's own farm message concedes that the government's past farm programs have led to "the drift toward a chaotic, inefficient, surplus-ridden farm economy." ❁

## Freedom to Bargain

February 26, 1962

In January electrical workers in New York City, who had been working a 30-hour week at \$4.40 an hour (\$6.60 for overtime), struck and demanded a twenty-hour week at higher pay. They finally settled for a basic five-hour day and 25-hour week at \$4.96 an hour, with a guaranteed sixth hour at \$7.44, or \$161.20 for a 30-hour week. The shorter week was demanded in spite of the fact that a serious shortage of skilled electricians already existed in the New York area.

There is hardly need to point out that the new contract (particularly if it becomes a "pattern") must reduce national production, raise the cost of factories and homes, reduce our ability to compete abroad, create unemployment, and lead to further inflation. The Kennedy Administration and even the AFL-CIO have disapproved the settlement. Yet the unreasonable demands were made and granted.

And now, to prevent a repetition of anything like the 116-day steel strike of 1959, or even abnormal stockpiling, the Administration has already intervened in the steel wage negotiations to plead with both sides for "industrial statesmanship" and "an early and noninflationary settlement in the public interest." Wages in the steel industry are already \$3.24 an hour compared with an average in all manufacturing of \$2.36.

#### FIXING RIGHT WAGES

Behind this intervention is the implication that the government knows what a proper or statesmanlike wage ought to be. This implication, in spite of many reservations, is found in the latest annual report of the Council of Economic Advisers. "The general guide for



noninflationary wage behavior,” it tells us, “is that the rate of increase in wage rates (including fringe benefits) in each industry be equal to the trend rate of overall productivity increase.” After describing “important modifications” of this guide, it concludes that “productivity is the central guidepost for wage settlements. Ultimately, it is rising output per man-hour which must yield the ingredients of a rising standard of living. Growth in productivity makes it possible for real wages and real profits to rise side by side.”

It is gratifying to find explicit government recognition that real-wage rates are limited by productivity. But the truth is that neither “overall productivity” nor “output per man-hour” can be accepted as a wage-rate guide. “Overall productivity” is not productivity of labor, but of land, labor, management, and capital combined. “Output per man-hour” is a misleading ellipsis for output per *man-machine-hour*. The council report itself admits this at one point: “Output per man-hour rises mainly in response to improvements in the quantity and quality of capital goods with which employees are equipped.” Now if the rise in productivity is mainly owing to the creation and use of more and better machines, and if all the money earned by these machines (and needed to amortize them) is to be sucked into high wages for the workers who use them, what incentive is left for new investment?

### EMPLOYERS COERCED

Why is the government drifting toward the idea of compulsory wage arbitration? The reason is that our one-sided labor laws grant so much power, privileges, and immunities to the labor unions that they can make unreasonable demands which the employers are impotent to resist. The latter find their own freedom to bargain abridged. The employers are legally forced to “recognize” and “bargain with” specific unions that are legally granted exclusive bargaining power. In addition, unions are allowed to use mass picketing and intimidation to prevent anybody else from taking the jobs that the union members have voluntarily vacated by a strike.

If these one-sided laws were repealed, if freedom, not merely of “collective bargaining” but of *all* bargaining, were restored, competition of workers and employers would set workable and “noninflationary” wages, prices, and profits, without need of coercive government slide rules. If two-sided freedom of bargaining is not restored, we will continue to drift toward compulsory arbitration, government wage and price and profit fixing, and totalitarian controls. ⚙

## Automation Makes Jobs

March 5, 1962

Ever since technological progress began, men have feared efficiency and machinery as a threat to their jobs. In the Industrial Revolution new stocking frames as they were introduced were destroyed by the handicraft workmen (more than 1,000 in a single riot), houses were burned, the inventors were threatened and obliged to flee for their lives. Yet before the end of the nineteenth century the stocking industry was employing at least a hundred men for every man it employed at the beginning of the century. And so with scores of other industries.

Yet the belief that machines on net balance destroy jobs, no matter how often disproved, never dies. Whenever there is prolonged unemployment, machines get the blame anew. In the depression of 1932, a group called the Technocrats emerged to blame the mass unemployment in that era once more on the machine.

Well, here we go again. A reporter at the press conference on Feb. 14 cited an estimate by the U.S. Labor Department that 1.8 million jobholders are replaced every year by machines. “How urgent,” he asked, “do you view this problem—automation?” And the President replied: “It is a fact that we have to find over a ten-year period 25,000 new jobs every week to take care of those who are displaced by machines and those who are coming into the labor market. So that this places a major burden upon our economy. . . . I regard it as the major domestic challenge, really, of the '60s—to maintain full employment at a time when automation, of course, is replacing men.”

### RECORD EMPLOYMENT

Now “automation,” in its broader sense, is simply the latest name for increased technological progress. To regard this as “a major burden” or “the major challenge” is to misunderstand it completely. It is true that machinery or automation can displace specific men from specific jobs, and this creates a problem. But it is not true that mechanization destroys jobs on net balance. Historically, it has always created jobs. In spite of our unemployment, U.S. *employment* in January exceeded 65 million, the highest for any January in our history.

It is important to understand not only that mechanization, automation or scientific progress has never reduced the total number of jobs, but just why it does not. First, a huge number of new jobs are created just to make the new automated machines. Secondly, scientific progress turns out innumerable products—telephones, motor cars, planes, air conditioning, radios, television, plastics, synthetics, miracle drugs—that never even

existed before. A huge new demand is created. Thirdly, automation is most often adopted because it reduces costs of production. This means that it brings down prices. Then people either buy more of a product or have more money left over to buy other products. More jobs are created.

### IT RAISES WAGES

Mass production, in brief, has made possible mass consumption. Mechanization increases production, real wages, and living standards.

When this is not understood, the policies adopted are precisely the opposite of what they should be. Unions no longer smash machines; but they still insist on slowdowns, make-work practices, featherbedding, retention of wholly unneeded workers, and other penalties to discourage mechanization. These policies injure all of us, and workers most of all.

It is not true, as the Administration thinks, that the government must “do something” to “find” jobs lost by automation. It is above all not true that it must resort to inflation or to massive new spending to “create jobs.” What it must *undo* are the ill-considered laws that have destroyed jobs.

To blame automation for current unemployment is to divert attention from the real cause. That cause is excessive wage rates in certain lines. It is no accident that some of our most serious unemployment is in the coal and steel industries, in which hourly wages have been \$3.10 and \$3.26 an hour respectively, compared with an average of \$2.34 an hour in all manufacturing. And these job-destroying wage rates are the result, in turn, of the special legal powers and immunities that government has conferred on the unions. ❁

## Jobs by Inflation?

March 12, 1962

The President has sent to Congress, accompanied by a letter urging its passage now, a pre-drafted “Stand-by Capital Improvements Act of 1962.” The proposed law would give the President authority to spend \$2 billion on expanded public-works programs whenever government unemployment figures signaled a slump. Projects would be designed to create jobs, inject Federal money quickly into the economy, draw state and local matching funds after it, and expand consumer purchasing power.

Congress is being asked, in effect, to transfer in advance part of its power of the purse to the President. The President’s argument for having these stand-by

spending powers is that, if a recession gave statistical signs of beginning, Congress would be incapable of acting soon enough. It is hard to see any force in this argument. In the event that statistics took the turn the President now contemplates, he could send an immediate emergency message to Congress on the day the discovery was made. If Congress were not in session, he could call a special session within a week. Congress could then act.

### CONGRESS CAN BE QUICK

The President, therefore, must either think that Congress is incapable of acting promptly, or that it might not wish to do so. The historic record shows that the first assumption is not true. Congress has repeatedly declared war within a few hours after being asked to do so by a President. In the early weeks of the Roosevelt Administration, in 1933, laws were often enacted within a day or two after they were proposed. On May 25, 1946, when President Truman asked Congress for authority to draft striking railroad workers into the Army, the House voted the same day to grant him the powers he had asked (an action fortunately later rescinded by the Senate).

If, however, the argument is that Congress may not *wish* to authorize the increased spending at the time when the trigger conditions envisaged by the proposed stand-by law occur, that is the best of all reasons why Congress should not enact a self-paralyzing law now. This is asking it to vote now not to trust its own future judgment, but to agree to be bound in advance to authorize an automatic response to a statistical barometer without knowing the full circumstances of a future situation.

If we turn from the political imprudence of the proposed law to its economic consequences, we find that it rests on all the old pump-priming fallacies—on the assumption that a net increase in jobs is always created by bigger deficits, achieved either by more spending or by cutting taxes—on the assumption, in other words, that more jobs can always be created by injecting more money into the economy—in plainer words, that the total number of jobs can always be increased by more inflation.

### KEYNESIAN FALLACY

This is the fallacy on which governments all over the world have been operating for the last generation, and especially since Lord Keynes built up an elaborate rationale for it in 1936. Those who believe in it forget that heavy unemployment has frequently occurred in the very midst of a major inflation. That increased deficit spending will bring on more inflation is practically certain; but whether it creates more jobs will depend

on whether or not prices rise faster than wage rates and increase profit margins. The Administration remains persistently blind to the effect of excessive wage rates in causing the unemployment of which it complains. Such wage rates, instead of being allowed to correct themselves, would under the proposed law be subsidized with Federal funds.

The only direct employment provided by the President's automatic pump-priming plan would be in the construction industry. But construction workers might be those in least need of subsidy. Today they earn an average of \$3.24 an hour, compared with an average of \$2.36 in all manufacturing and \$1.71 in retail trade.

Finally, the projects on which the \$2 billion would be spent would be projects dreamed up just to spend the money. For the inference is that if the unemployment thermostat did not hit the trigger levels, we could get along without the projects. ❁

## How to Remove Barriers

March 19, 1962

The proposal that we associate ourselves with the European Common Market has diverted attention from the real problems of American foreign trade. Administration spokesmen talk as if such an association would be necessarily a step toward lower trade barriers in general, and as if any other course would be necessarily toward more protection. But the problem is less simple than that.

1—It may be wise for us to bargain with the Common Market. But this would not necessarily be a step toward freer trade. It is still uncertain whether the Common Market will prove to be a step toward freer world trade or toward bigger inward-looking, discriminatory, protectionist blocs. The Common Market does not seem to be welcoming Britain with great fervor or the associate membership of such neutrals as Austria, Switzerland, and Sweden. It has still not decided whether it is primarily economic or primarily political. It is still to be seen whether it can hold together in spite of nationalistic suspicions, jealousies, and interests. It is doubtful it can hold together in the long run unless the six nations adopt a common currency or complete currency convertibility based on a common gold standard.

2—Our most important need is not to start bargaining reciprocal concessions with the Common Market, but to make and keep ourselves competitive in foreign trade. This means that we must slash, and not increase, Federal spending; that we must stop the deficits; that we must halt inflation, and every policy that

undermines confidence in the dollar. We must keep down our prices and costs. We must revise or repeal all Federal labor laws that encourage excessive union demands and lead to faster rises in wage rates than in marginal labor productivity. We must revise our tax laws to give more incentives to industry, particularly for investment in cost-cutting or quality-raising equipment. Only such thoroughgoing reforms can keep us competitive in world markets.

3—The first step we must take in reducing foreign trade barriers is to abolish the import quota system we have been building up in recent years—on sugar, on petroleum, on cotton textiles. There is no legitimate aim of a quota system that cannot be accomplished as well or better by a tariff. Quotas are a totalitarian device that require detailed farm-by-farm or firm-by-firm output or import quotas, that reduce or eliminate competition even by domestic producers or importers with each other. A tariff at least permits domestic competition, and so tends to hold down domestic costs. It also brings in revenue.

4—When we have abolished quotas, we can start reducing tariffs. But it is extremely important that this be done *gradually*, to bring a minimum of disruption to industry, and to allow time for adjustment. Tariffs might even be reduced, by pre-set schedule, by very small changes month by month over a number of years. It is violent and unforeseen changes in tariffs, either way, that cause most uncertainty and disruption.

5—The worst course would be to reduce tariffs suddenly or sweepingly and then, as the Administration bill proposes, offer government cash payments or other forms of "adjustment assistance" to the workers or firms injured. It would be impossible, in fact, to know precisely how much or which unemployment or injury could be attributed to a tariff reduction. The decision would have to be arbitrary. "Adjustment assistance," in brief, will lend itself to discrimination, favoritism, and corruption, and will expand the area of government paternalism and controls.

### SELF-DEFEATING CURE

There is no good reason, moreover, why workers presumptively unemployed because of tariff changes should be more generously treated in length or amount of benefit payments than workers unemployed through other reasons that may be no direct fault of their own. Or why firms presumptively hurt by tariff changes should get better tax treatment or bigger government loans than firms hurt by other causes outside their control. To keep our high-cost inefficient producers going artificially, at public expense, would defeat the very purpose of tariff reduction.



And high tariffs, bad as they are, are infinitely less dangerous to a free economy than paternalistic government subsidies, direct or indirect. ❁

## Incentives Bring Growth

March 26, 1962

My colleague Raymond Moley has just written the biography of a remarkable man—*The American Century of John C. Lincoln* (Duell, Sloan and Pearce, \$4.95). John Lincoln was a genius peculiarly American—a sort of amalgam of Thomas Edison and Henry Ford. Like Edison, he was a prolific inventor. He took out 54 patents over a period of 65 years. Like Edison, again, his inventions showed amazing versatility—electric motors, brakes, drills, arc lamps, apparatus for curing meat, new types of steel springs. His chief contributions were in the field of electric welding of metals. As with Edison, some of his schemes and inventions were commercial failures, but his successes enormously outnumbered them. Like Edison, finally, his interest was primarily in invention or problem-solving for its own sake, rather than in the profits that it brought.

There were also, in his career and temperament, striking similarities to Henry Ford. His genius was dominantly practical. He was constantly devising methods of reducing costs, of making things cheaper, faster, better. Like Ford, he lived far below the level that his income would have permitted, and kept plowing back his profits into the expansion of his business.

### PHENOMENAL WAGES

He started the Lincoln Electric Co. in 1895 with a capital of \$200. By 1906 it was duly incorporated with a capital of \$10,000. Its twenty employees grew to 70 by 1910, to 100 by 1911, to 150 by 1914. In 1907 Lincoln's brother, James F., his junior by seventeen years, entered his employ at the age of 24. In 1913, at 47, John decided that he preferred a life of engineering and invention to a career as a business executive. As he found in James all the characteristics that make a successful head of a growing company, they entered into an arrangement in 1914 by which James took over the business management.

Under James's management, the business of the company grew prodigiously. In 1961 it had 1,345 employees and did a gross annual business of nearly \$60 million. Its prosperity has been based on the inventive genius of John C., on an initial lead in building certain types of motors, concentration on finding lower-cost methods, the wise use of engineering talent, and

the "incentive management" system of James F., including profit-sharing, piecework, bonuses, employee stock ownership, and merit rating. Lincoln Electric's wage policy has been extraordinary. The earnings of its factory workers range from \$5,500 to \$14,000 a year.

### LINCOLNS AND FORDS

John C. Lincoln died in 1959, at the ripe age of 93. What is amazing is the range of his activities and inventions after he had passed the conventional retirement age of 65. He was making major inventions after 70. At 78 he took over and rehabilitated the Bagdad copper properties. In his late 70s, he wrote and published an analysis of the New Testament, and was actively preaching and propagating the tax theories of Henry George.

Will there be another career like that of John C. Lincoln? asks Moley at the end of his book. That, I am inclined to answer, depends on our future national policy. Certainly there will be other men born with the temperament of John Lincoln—men to whom life is a constant adventure and an unending quest, men with tireless drive and unquenchable curiosity, men more interested in invention and problem-solving than in any money profit that may come from them. But an atmosphere of hostility toward business, a tax on corporate profits of 52 percent, and of up to 91 percent on the personal income that may remain, must drastically restrict what even such men can achieve.

The profits that men like Henry Ford and John C. Lincoln plowed back into their businesses, increasing employment, production, wages and the amenities, welfare and living standards of the consuming community, were as surely "devoted to a public purpose" as any government activity. It is this capital investment that is the true and only source of that "national economic growth" that our political leaders profess to be so eager to increase. It will not be increased, but retarded, by punitive taxation, reckless government spending, and printing more paper money. ❁

## Are Consumers Boobs?

April 2, 1962

If you believe the books of Vance Packard and J.K. Galbraith and the speeches of Senators Kefauver and Douglas, the consumer is an ignoramus and a fool, unable to compare one product with another, swallowing every advertising claim, incompetent to spend his own money. The President's 5,000-word message to Congress on March 15 (his fourteenth this year) implies that these assumptions are correct. So he calls



for scores of new Federal controls, and an army of new bureaucrats to enforce them.

If these assumptions are true, the country would be in a bad way. For if the American people are too stupid to buy intelligently, how can they be expected to vote intelligently, or to know how to discriminate among the rival claims of politicians?

Yet the consumers may not be as helpless as Mr. Kennedy assumes. He says: "They are the only important group in the economy who are not effectively organized, whose views are often not heard." They do not need to organize. Their views are heard every day in their purchases and failures to purchase. With every penny that he spends, the individual consumer is casting his vote for this product or against that. He does not need to sign petitions or march on picket lines. If he patronizes a product, the firm that makes it prospers and grows; if he stops buying a product, the firm that makes it goes out of business. The consumer is the boss. The producers must please him or die.

### THE REAL PROTECTION

The great protection of the consumer is competition. It is true, as the President says, that advertisers (like politicians) utilize "highly developed arts of persuasion." But their advertising is *competitive*. When each of a score of firms in each line claims that its coffee, or *its* cigarette, or *its* car is the best, the consumer must compare. If a coffee, say, is not to a housewife's liking, she buys only one can, and then tries another. She does not have to stick with one brand (as she does with one senator) for six years. If she feels cheated in quantity or quality, she does not repeat her purchase.

Even the President's message admits that: "The typical supermarket before World War II stocked about 1,500 separate food items—an impressive figure by any standard. But today it carries over 6,000." This enormous range of choice was produced by freedom and competition, not by government restraints and bureaucrats.

Yet Mr. Kennedy's solution for every problem seems to be more and more laws, more and more agencies, thousands of more bureaucrats, more and more government power, controls, and restraints.

### SOME PROPOSALS

Space permits no adequate examination of his many specific proposals. The First National City Bank of New York, in its March letter, has already explained what is wrong with schemes to force disclosure of the "truth" about interest rates. Mr. Kennedy wants manufacturers to be *compelled* to make a specified type of TV set. He wants Federal bureaucrats to have power to forbid the sale, not merely of unsafe drugs, but of drugs that *they* decide are "ineffective" or "worthless." This

would not only ruin firms, but prevent the very clinical experience by which the relative merits of new drugs must be tested. Is this "protecting" the consumer? And would the principle be extended to allow bureaucrats to forbid the sale of "ineffective" or "worthless" paintings, newspapers, magazines, or books?

In spite of its length, there are a lot of things missing from the President's message. Nothing is said about what the Federal farm program does to raise prices against the food consumer; or how import quotas on oil, sugar, and textiles boost the prices he pays; or how excessive wage demands and featherbedding affect consumer prices and choice. Mr. Kennedy wants "more adequate protection for savings." But the gravest threat to savings has come from inflationary government spending.

The best way of protecting the consumer is not mentioned by the President. It is not to harass, threaten, hamstring, or intimidate the producer. It is to encourage the producer, by lower taxes and fewer restraints, to invest in new equipment, to expand, and so to reduce costs and prices and increase production. ☼

## A Wrong Turning

April 9, 1962

Thirty years ago, the idea took hold in Washington that strikes and most other labor troubles were caused by the weakness of unions and of labor's bargaining power. So the Wagner Act was passed in 1935 to encourage the formation of unions, to grant them exclusive bargaining powers, and to compel employers to "bargain with" them.

The act had two main purposes. One was embodied in its very title: "An Act to Diminish the Causes of Labor Disputes Burdening or Obstructing Interstate and Foreign Commerce." The other was to enable unions to raise wages. The first aim was not realized. There was an enormous increase in labor disputes. There were three times as many strikes a year in the decade following the Wagner Act as in the decade preceding it. Whether and to what extent the second aim was realized is a matter of dispute. *Money* wages were probably forced up higher than otherwise, but it is doubtful that *real* wages were. And excessive wage rate increases in certain lines brought unemployment and a decrease in total real wage payments.

The Taft-Hartley Act of 1947 amended the Wagner Act but retained its provisions granting exclusive bargaining power to government-certified unions and forcing employers to "bargain with" these unions no

matter how unreasonable or adamant their demands. And under the Norris-LaGuardia Act of 1932, the employer has been in effect left without recourse against coercion, violence, and mass picket lines to prevent other workers from taking the jobs voluntarily abandoned by strikers.

### WHAT THEY FEAR

Yet events have taken an ironic turn. In recent years the chief fear of government officials has not been that unions would be too weak to demand sufficiently high wage rates, but that they would be so strong that they could demand and get excessively high wage rates—wage rates that would force more inflation, price us out of foreign markets, imperil the dollar, bring unemployment.

This is precisely the fear of the Kennedy Administration today, the most “pro-labor” government that the country has ever had. It is the fear of the chairman of the President’s Council of Economic Advisers, Dr. Walter W. Heller, and of the Secretary of Labor, Arthur J. Goldberg. Both hoped for a “favorable” outcome of the Big Steel wage negotiations. And by a “favorable” outcome they meant a wage increase that was *not too high*. And so they are delighted by the “noninflationary” tentative settlement of the steel wage dispute.

### VAGUE ‘GUIDELINES’

To prevent excessive wage-rate increases Secretary Goldberg proposed a government voice in the terms of settlement. Though he denied that he wanted compulsory arbitration of labor disputes, his speech on Feb. 23 came very close to demanding this. In a “definitive” statement of Administration policy, he declared that Federal mediators must “increasingly provide guidelines” at the bargaining table to insure settlements “in the public interest.”

These “guidelines” had to do with “productivity.” The last annual *Economic Report of the President* assumed that such “productivity” can be statistically measured and that such “guidelines” can be set. But this “productivity” turns out to be a very nebulous concept. It has nothing directly to do with physical output per man-hour. The productivity that determines wages is *marginal labor* productivity. But there is no statistical way of determining this, except hypothetically and retroactively.

George Meany, the president of AFL-CIO, was right, therefore, when he called Secretary Goldberg’s statement “a step in the direction of saying the Federal government should tell either or both sides what to do.” And the NAM is right when it fears that Goldberg’s proposal would “lead to government regulation and control of the economy.” The government seems driven

in this direction because it fears the consequences of excessive union bargaining power. Yet no one dares to ask whether our laws took a wrong turning in the 1930s and whether we should not simply revise or repeal the legislation that created the present union dictatorship. ☸

## A Duty of Congress

April 16, 1962

In the Constitution, Congress alone is granted power “to lay and collect . . . duties” and “to regulate commerce with foreign nations.” In the government’s tariff bill Congress is asked to make a sweeping delegation of these powers to the President.

Few people realize how sweeping that delegation is. Discussion has centered around the proposal that the President be given power to reduce this country’s existing tariffs by as much as 50 percent in return for comparable reductions by other countries—and even to cut tariffs to zero on items on which the U.S. and Common Market together account for 80 percent or more of aggregate world export value. But the bill would also give the President power: (1) To *increase* any tariff by 50 percent over “the rate existing on July 1, 1934” (i.e., before any of the reductions made in 28 years of reciprocal agreements); (2) to levy *new* tariffs on duty-free goods up to half of their value; and (3) to impose any “other import restriction . . . as he may determine to be in the national interest.”

### AN ACT TO ABDICATE

So the Trade Expansion Act of 1962 might more appropriately be called “An Act to Abdicate the Constitutional Power and Responsibility of Congress over Tariffs and Trade and to Turn Everything over to the President.”

There is, of course, a practical argument for a limited delegation of power in this field. Though reciprocal-trade agreements rest on dubious assumptions, Congress has already been delegating its tariff-making powers for 28 years. Individual agreements often involve more than a thousand items. Congress as such is hardly equipped to bargain separately with each foreign country or trading bloc.

But that is no reason why it need surrender its constitutional powers and responsibilities, tie its own hands in advance, and reduce itself to impotence in this field. It can and should provide that the President submit every trade agreement to Congress, but that an agreement go into effect in 60 days unless either house votes against it.

There are ample precedents for such a provision. It is precisely the provision in the Reorganization Act (which enabled Congress to halt the proposed Department of Urban Affairs). The President himself, in asking a few weeks ago for discretionary powers to cut income taxes, suggested that such powers be "subject to Congressional veto."

### CONGRESSIONAL VETO

Yet Under Secretary of State Ball declares: "It would greatly weaken the negotiating position of the United States if it could go through the great agony of making a very complicated trade agreement and then not be able to assure the country with which it was making it that it would be a binding treaty."

If this argument is sound, the Senate should be deprived of its constitutional power to ratify treaties by a two-thirds vote or to reject them by a vote of one-third plus one. This constitutional provision is a far more formidable hurdle than the safeguard here proposed. It requires a positive two-thirds majority endorsement by the Senate, which can let a negotiated treaty die by mere inaction. Under the proposed Trade Expansion bill amendment, a trade agreement would automatically go into effect unless at least one house acted adversely on it within 60 days. Surely Congress should not allow any agreement to go into effect to which even one house is actively opposed.

Nor is there any substance in Ball's "agony" argument. Both sets of government negotiators would be paid for their work and time. Those of the foreign country would lose nothing by their own tariff concession if the agreement were rejected; the concessions would simply not go into effect. Our own negotiators would be put in a stronger rather than a weaker bargaining position; they could argue that, if they conceded too much, Congress might kill the whole agreement.

Finally, turning power over to the President is no guarantee against political logrolling—as illustrated by Mr. Kennedy's order for a sharp increase in the tariffs on woolen carpets and glass, the bulk of which comes from Belgium, in order to win sectional support for his program. ❁

## Why Stunt Our Growth?

April 23, 1962

To provide more incentive for capital investment, the Administration has proposed that businesses investing in productive equipment be granted a flat-rate tax credit of 8 percent of the amount of their investment in any year. In addition, the Treasury has begun to reduce its

estimates of "useful lives" of property to permit business to take somewhat quicker depreciation allowances than before.

These are certainly steps in the right direction. A modification of the first proposal (a 7-percent tax credit) is embodied in the tax bill as it passed the House and is now before the Senate. But is this proposal excessively generous, as some senators think? Or is it insufficient? And is it better or worse than other proposals designed to attain the same result?

Careful estimates indicate that, as a result of inflation combined with a shortsighted past depreciation policy, about \$100 billion of plant and equipment in this country is obsolete and in need of replacement. Other careful estimates hold that our underdepreciation of plant and equipment amounts to \$5 billion to \$8 billion a year. On this basis business is paying \$2.5 billion to \$4 billion more in annual taxes than it would with adequate depreciation.

### OBSOLETE PLANTS

If these calculations are reasonable, then even if the Treasury was correct in its first estimate that its proposed 8-percent credit would mean a tax cut of \$1.2 billion a year at the outset, the tax credit would still not enable industry to write off adequate depreciation.

But how does the proposed tax credit compare, in fairness or as an incentive to modernization and new investment, with the method generally used in Europe in recent years, of allowing faster depreciation write-offs or a bigger initial write-off?

The tax credit would no doubt provide some incentive to new investment. But compared, say, with allowing a bigger initial write-off, it would have disadvantages both for industry and for the government. It would favor the already prosperous and growing industries over the older or more depressed. It would favor investment in short-lived rather than in long-lived assets. It would be more expensive for the government, because it is a direct offset against a corporation's tax and would not reduce subsequent depreciation allowances. George Terborgh of the Machinery and Allied Products Institute has calculated that it would require at least a 40 percent initial write-off to match an 8 percent tax credit in overall terms.

### FOR FASTER WRITE-OFFS

If it is a choice of one or the other, therefore, allowing faster depreciation on write-offs or a big initial write-off seems fairer as between companies, more promising in the long run as investment incentive, and ultimately better for government revenues, than the proposed tax credit.



The advantage of allowing faster write-offs or a big initial write-off is that the government gets the money back. A corporation can never write off an asset for more than its total cost. If it is allowed to write off 40 percent of that cost the first year, it has only 60 percent left to write off in later years. Depreciation adjustments involve merely transfer of income from one year to another. Past insistence by the Treasury on slow depreciation over the so-called "useful life" of an asset has been not merely arbitrary but shortsighted.

The Treasury itself stands to gain from liberalized depreciation allowances. Maurice E. Peloubet, a certified public accountant, has persuasively argued for adoption of the Canadian method of capital allowances and for "reinvestment depreciation." A Senate subcommittee recently concluded:

"Liberalized depreciation allowances would generate enough new taxable earnings among producers of capital goods to offset the tax loss from lower profits resulting from increased depreciation allowances. . . . It is doubtful that there would be any revenue loss in the second year after such liberalization, and perhaps none in the first. . . . The economic growth and resulting greater tax base under new depreciation policies should assure the Federal government of a long-term gain in revenue." ❁

## Blow to Confidence

April 30, 1962

*"But what good came of it at last?" . . .*

*"Why, that I cannot tell," said he;*

*"But 'twas a famous victory."*

Let us see where the President's great victory over the steel companies is likely to lead us.

The principle has been established that the price of steel, or of any other commodity, ought to be what Mr. Kennedy says it is. How does he know this "right" price? Presumably from his Council of Economic Advisers. They not only know what each price ought to be but what each wage ought to be. In their last annual report they laid down confident "guidelines." Secretary Goldberg announced that the government would not stand idly by and let wages be decided by free bargaining. It would insure settlements "in the public interest." When the steel unions settled for an added labor cost of only 10 cents an hour in the first year, he and the President hailed the settlement as "responsible" and "noninflationary."

There was no Presidential blast at the steel unions for forcing this settlement. Nobody in the White House pointed out that since the steel industry had last adjusted its prices in 1958 there had been four increases in steel wages and benefits amounting to some 40 cents an hour; that the new increase would add another 10 cents; that as compared with average wages of \$2.38 an hour in manufacturing in general, wages in the steel industry were already \$3.01 an hour—and, plus fringe costs, \$4.10 an hour.

### STEEL AS SCAPEGOAT

No, the union was congratulated for its moderation and "statesmanship," and for getting still another "noninflationary" rise. But when U.S. Steel, in a belated effort to catch up on an increase in employment costs of 12 percent since 1958, and a net increase of 6 percent in all costs, announced a price increase of 3½ percent, the White House turned loose all its fury. It denounced the increase as "a wholly unjustifiable and irresponsible defiance of the public interest."

The steel companies have long been Washington's No. 1 political whipping boy. When a 40-cent hourly package pay increase and a 30-month contract were forced on them in 1960, they were warned not to raise prices and didn't. Last September Mr. Kennedy again warned them that they mustn't raise their prices to meet the coming wage increase on Oct. 1. Yet many now say that the recent announcement of price increases was "badly timed." Apparently it is never the right time to raise steel prices, no matter what happens to costs.

According to the new mythology, the cause of inflation is not the enormous increase in the money supply, not irresponsible Federal spending, not chronic deficits, not one-sided laws which give labor unions power to demand ever greater wage increases and to boost production costs. The cause of inflation, we are told, is refusal of the steel industry to "absorb" all these costs.

### VICTORY FOR WHOM?

The result of the Administration's policy must be to stunt the steel industry—the foundation of our national defense. Our government wants a big, strong, modernized, growing steel industry—but it mustn't make profits. In 1961 steel stood only 33rd out of 41 manufacturing industries in return on net assets. Only once in the past twenty years have profits in the industry equaled the 8 cents per dollar of sales that they reached in 1940. In 1961 they were about 5 cents. Yet funds for modernization and expansion can come only out of past profits or out of borrowing in anticipation of adequate future profits. U.S. Steel's profits available for



reinvestment dropped from \$115 million in 1958 to less than \$3 million last year.

As Professor Livernash of Harvard put it in a report prepared for the Department of Labor in 1960: "Obviously while price policy can be debated in the short run, in the long run all cost increases must be met." But suppose a President, through lawless price fixing by fury and threat, can prevent cost increases from being met? Then economic growth, modernization and expansion of plant, employment, wages, and output, must all be less than they would have been.

The President has struck a heavy blow at all business confidence. Who can gain from a climate of fear? ❁

## 'In the Public Interest'

May 7, 1962

Unless prompt and convincing steps are taken to offset the consequences of the President's "cold fury" press conference of April 11 and the punitive measures that followed, unmeasurable harm may be done to American industry.

In that press conference Mr. Kennedy denounced the steel price increase as "a wholly unjustifiable and irresponsible defiance of the public interest." His private expressions appear to have been even more sweeping. *The New York Times* reports him as having said: "My father always told me that all businessmen were sons-of-bitches but I never believed it till now."

In a belated statement on April 19, the Joint Senate-House Republican leadership listed nine actions that followed this conference, ending with that of the FBI in "routing newspapermen out of bed at 3 a.m." for questioning. The Republican group declared that collectively these actions "imperiled basic American rights, went far beyond the law, and were more characteristic of a police state than a free government." The Democratic leadership denied none of the Republican allegations of fact. It simply "commended" the President "for taking every appropriate step he could to . . . preserve the public interest."

### SHOCK TO CONFIDENCE

Where does this leave us? It leaves us with an illegal form of price control enforced by denunciation, threat, and intimidation. And nobody knows the new rules. Which businessman can raise the price of his product? By how much? When? In the steel industry we now have a price freeze of unpredictable duration. Under what circumstances, and at what level of labor costs,

will a rise in steel prices—or in any other price—cease to be a crime? What is the standard? The personal opinion of the President? Must every price or wage rise be submitted to him in advance?

The President's action has given a severe shock to business confidence. There is already a profit squeeze. In the last sixteen years corporate profits have been dropping both as a percentage of national income and as a percentage of sales. As a McGraw-Hill compilation has shown, profits dropped from 5 percent of sales during the years 1946–50 to 3.6 percent during 1951–55, to 3.2 percent during 1956–60, and down to 3.1 percent last year. Last year, also, the steel industry stood only 33rd out of 41 manufacturing industries in return on net assets.

A leading Soviet ideologist has just repeated that Russia is "further expanding heavy industry, the cornerstone . . . of the defense of the country." The President wants faster economic growth and especially a growing steel industry. Yet our expansion can only be financed out of profits. How many steel men—or any other businessmen—will go ahead with heavy capital spending programs when they do not know whether they will be allowed to set prices, subject only to keeping competitive, or where they will be allowed to set them?

### UNKNOWN RULES

Sensing the disquiet and fears to which his actions have given rise, and their threat to economic growth, the President on April 18 announced that his Administration "harbors no ill will against any individual, any industry, corporation, or segment of the American economy." He admitted "the steel industry's need for profit, modernization, and investment capital." He declared that "this is a free economy." He insisted that his action had not set a precedent. "I have not suggested that . . . we have powers to set or that those powers would be desirable to set—prices or to set wages." But he repeated that he had a "responsibility" to intervene in steel prices because "the public interest" was "mandatory." Thus one thing contradicts another and everything is left ambiguous.

And the central question remains unanswered. Which is really in "the public interest"? That prices be fixed in accordance with the President's personal opinion? That profit margins in steel be squeezed tighter, investors frightened, and investment in new steel plant discouraged? Or that industry management be free to try to set prices to yield profit margins that encourage the industry to grow, with a rise in employment and real wages? ❁

## To Restore Confidence

May 14, 1962

The speech of the President before the U.S. Chamber of Commerce was gratifying not only for its conciliatory tone but for its recognition of the crucial role of profit in the American economy:

“We want prosperity and in a free enterprise system there can be no prosperity without profit. We want a growing economy, and there can be no growth without the investment that is inspired and financed by profit. . . . Our primary challenge is not how to divide the economic pie, but how to enlarge it.”

Yet, as the response of the stock market has shown, it will take more than verbal reassurance, no matter how well phrased, to restore the confidence so badly shaken by the President’s outburst of April 11 and by some of his subsequent actions. Here are seven measures that might help:

1—The President should abandon all hints that price and wage controls may be desirable or necessary unless labor and management act, in his judgment, “responsibly.” It is not enough for him to say that “We [in Washington] do not want the added burden of determining individual prices for individual products.” He must recognize that the task is impossible, and that it would do immeasurable damage to the economy for the government to attempt it. There are millions of separate prices and billions of interrelationships of prices, wages, and costs. These ever-changing interrelationships determine how much of thousands of different commodities are produced, and when, and how many workers are employed, and where. Arbitrarily to hold down the price of one commodity must reduce its production and disrupt the production of scores of others.

The President must also abandon the belief, sold to him by his Council of Economic Advisers, that any “scientific” formula has been found for fixing prices and wages. He must above all abandon the delusion that wage hikes of 3 percent a year, combined with a price freeze, is such a formula. Any attempt to apply this crude formula would be disastrous.

2—The President should stop asking for increased discretionary powers for himself. Congress should stop abdicating its legislative responsibilities and stop granting him such powers.

3—There should be no more anti-business taxation. This applies particularly against the new tax proposals that would penalize the competitive position of American firms operating abroad. The proposed withholding tax on dividends and interest should be postponed for additional study.

4—The Administration and Congress should halt reckless “welfare” spending. They could begin by slashing a few billions out of farm price supports and foreign aid. If this gross inflationary spending were cut, the Administration would not have to impose still more growth-choking taxation to “balance the budget.”

5—In addition to refraining from measures that shake confidence, the Administration should take positive measures to instill it. Far better than the proposed 8-percent investment tax credit, for simplicity, justice, and incentive, would be to permit an initial depreciation write-off of 30 or 40 percent in the first year, and 10 percent in subsequent years. In the long run, precisely because it gave a strong incentive to new investment and growth, the government would gain not lose revenues.

6—The jungle of our antitrust laws should be re-explored. It has become impossible for the heads of big corporations to know when they are violating one of these “ten thousand commandments,” most of which are ambiguous and many of which conflict with each other. Their enforcement has been haphazard, selective, and discriminatory. Government officials have been able to use them for harassment and intimidation. We might begin by eliminating criminal penalties and by repealing the Celler-Kefauver and Robinson-Patman acts.

7—The double legal standards in dealing with big business and big unionism have led to disorder. But the way to curb unreasonable union demands is not to make the unions subject to the antitrust acts, as so widely proposed, nor to give the President more power to intervene in strikes or set wages, as recommended by a Presidential panel, but to stop tolerating union violence and intimidation and imposing one-sided bargaining compulsions on the employer that force capitulation to strike demands. ☸

## Free Prices, Free Wages

May 21, 1962

The market economy is a marvelous but infinitely complicated mechanism. It was once moderately estimated that there are some 9 million different prices of all goods in the United States. This would imply more than 40 trillion *interrelationships* of these prices.

Under the play of supply and demand these prices change from day to day and from hour to hour. So do their interrelationships. These changes in relative prices, wages, costs, profits, and losses are daily changing the

pattern of consumption and production, driving firms and workers out of some lines and drawing them into others. It is through this wondrous mechanism that the relative output of thousands of different commodities and services, in accordance with the relative demand of consumers, is determined.

If, now, a government official, substituting his personal judgment for that of the market place, steps in to hold down one set of prices (say of steel), what will happen? Because of the smaller relative profit margin, the output of that product will decline. Suppose the government keeps inflating, by undermining confidence in the dollar and increasing the money supply, thus putting upward pressure on all prices and wages, but then insists that everybody must “hold the line” and freeze prices? Then it will impair or nullify the function of the whole price-cost mechanism, disrupt and disorganize production, and bring shortages and unemployment.

### THE 3 PERCENT FALLACY

Yet there are people who are not only presumptuous enough to suppose that they can fix prices better than the market can fix them, but that they can do this by some simple pat formula. The Council of Economic Advisers, in its last annual report, put forward its own “guidelines” for prices and wages. It modestly disavowed omniscience. It conceded that “productivity is a *guide* rather than a *rule*”; that “this is a large and complex subject and there is still much to be learned”; that it had no “mechanical formula for determining whether a particular price or wage decision is inflationary.”

But suddenly the “guidelines” became clear rules and the government knew all. Any price rise whatever (especially in steel) was “inflationary,” but a wage-rate rise or labor-cost rise of 3 percent or less was “non-inflationary.” The President denounced the steel-price rise as a “wholly unjustifiable and irresponsible defiance of the public interest”; but he congratulated the steel union leaders for their “statesmanship” in forcing another 2½ percent labor-cost rise. And when a Presidential emergency board recommends an increase of 10.2 cents an hour, or more than 4 percent, for non-operating railroad employees, the President declares himself “gratified” that the recommendation falls within the council’s guidelines.

### THREAT TO EMPLOYMENT

These “guidelines” are economic quackery. The council’s own figures show an average annual growth of output per man-hour from 1947 to 1960 of 2.8 percent. But this varied every year. Average man-hour output in 1956, outside of agriculture, was lower than in 1955.

The rate of change was different in every industry in every year, and in every firm within every industry. To impose a Procrustean annual hourly labor-cost increase of 3 percent on every industry and firm would disrupt profits, employment, and production. The formula ignores, moreover, all differences in past increases in wage rates. The average wage increase in the apparel and textile industry in the period 1947–1960 was 38 percent; in steel 113 percent.

Suppose, however, there really was everywhere an increase in man-hour productivity of 3 percent a year? Such increases as occur are brought about, not because everybody works harder every year, but because there has been an increase in investment in new plant and equipment. If the whole of the increased productivity goes to labor, where will the funds come from and where will the incentive come from for future investment?

Any formula whatever of government price and wage control overlooks and destroys the whole function of free prices and free wages, which is to guide and stimulate production, investment, and employment. ❁

## Wages Must Be Free

May 28, 1962

Successive statements have only increased the ambiguity of the President’s attitude on price and wage control. “This Administration,” he told the convention of the United Auto Workers, “has not undertaken and will not undertake to fix prices and wages in the economy.” That sounds clear enough, but he continued: “We can suggest guidelines for the economy, but we cannot fix a single pattern for every plant and every industry. We can and must under the responsibilities given to us by the Constitution and by statute and by necessity point out the national interest.”

Mr. Kennedy denies that he either has or seeks power to fix prices or wages. But he did in fact force the steel industry to rescind its price increase in April. By his action the price of steel is now frozen for an unpredictable period. He denies that he either has or wants any legal powers over prices and wages—but he insists that he has “responsibilities” concerning them. How can one have “responsibilities” where one has no power? He declares that his responsibility is to point out “the national interest.” Is he alone competent to say what the national interest is? Are price-fixing by anger and threat, and profit margins too thin to permit or encourage industrial growth, in the national interest?



### PHANTOM 'GUIDELINES'

There is a great deal of confusion on this central point. Even "conservatives" ask whether the President will be just as "tough" in holding down wages as in holding down prices. They forget that it would be enormously dangerous and disruptive for him to dictate either. Only free markets can coordinate the millions of prices and wages, and decide the ever-changing price-wage-cost-profit-loss pattern of relationships that will maximize production and employment and provide goods and services in the proportions that best meet the demands of consumers. This incalculably complicated problem cannot be solved either by pat formulas or by vague generalities about "productivity" and "guidelines."

Last week I discussed here some of the fallacies in the Administration's notion that wage rises of 3 percent a year are "non-inflationary" because of a supposed annual rise of that amount in "man-hour productivity." The phrase itself is dangerously misleading. It is an ellipsis for man-*machine*-hour productivity. A power mower may enable your gardener to cut your lawn in half the time a hand mower would take. But if he demanded an increase in wages from \$2.50 to \$5 an hour, on the ground that his "man-hour productivity" had increased 100 percent, there would be no point or incentive in your buying the power mower.

### DISRUPTIVE CONTROLS

This problem is commonly discussed as if it could be solved by some moral calculus. If new machines increase productivity, how "ought" the gains to be shared as among labor, capital, management, consumers, etc? The problem cannot be solved in such pseudomoral terms. Only free markets can solve it. Free competition tends to give to workers, managers, and investors what each contributes to production. Productivity and competition decide not what everybody "should" get but what he *can* get. A movie star's salary is not fixed by what is "fair" but by what she brings in at the box office.

Why is Mr. Kennedy talking about price and wage control at all? First, because his Administration is following dangerously inflationary spending and monetary policies. But to inflate, and then to try to prevent the consequences of inflation by freezing prices and wages, is the most disruptive of all policies. Secondly, the pressure for both price and wage control exists because some unions are making and winning unreasonable demands which threaten both industry and employment. They are making and winning these demands, however, because under existing laws an employer is legally *forced* to bargain with a specified union, while unions are allowed to use violence, intimidation, and

mass picketing to prevent struck employers from trying to carry on their business.

The cure for all this is not still more government intervention. It is to restore the conditions everywhere for competition and free markets. ☼

## Toward Freer Trade

June 4, 1962

The president has been eloquently and rightly pleading that we should not move toward economic isolationism but toward greater freedom of international trade. But the Administration's Trade Expansion bill bears little relation to this plea. It is not primarily a bill to reduce trade barriers. It is a bill under which Congress would abdicate its constitutional tariff powers and turn them over to the President—including the power to raise as well as lower tariffs, to impose import quotas, and to decide which firms and workers should receive special and discriminatory doles and which should not. Every such determination by the President and the "administering agencies" would be final and conclusive, and not reviewable by any court.

A bill primarily designed to reduce international trade barriers would not have to be an enormously complicated 61-page document. It need have only two main provisions: (1) It would abolish all import quotas and similar non-tariff impediments to trade. (2) It would provide unilateral tariff reductions. These reductions would be smooth and gradual, extending over a considerable period, say ten years, to allow time for adjustment and to minimize disruption. They would contain the most-favored-nation clause.

### AMENDMENTS

I made essentially these suggestions in previous *Newsweek* articles in the issues of Dec. 25 and Jan. 1 last. Similar recommendations have been made in a remarkable article by Prof. Milton Friedman in *National Review* of May 22. But they may sound academic in view of present sentiment in Congress and 28 years of reciprocal tariff negotiations. The more immediate question is what are the minimum changes in the Trade Expansion bill that would lead toward real freedom of trade and retain constitutional processes and protections.

1—The bill should abolish all import quotas or provide for their abolition over a reasonable period. These are today a far more serious barrier to trade than tariffs. We have had for years a creeping quota system. We now have import quotas on some agricultural products,



notably sugar, on petroleum, and on lead and zinc, as well as “voluntary” export quotas on textiles imposed on Japan and Hong Kong. As between quotas and tariffs, tariffs are in every way to be preferred. Quotas are discriminatory, require individual allocations, lead to growth of bureaucracy, become weapons of punitive action or of favoritism, and breed corruption.

2—Of the 61 pages of the original Administration trade bill, 38 are devoted to “adjustment assistance.” These provide for discriminatory doles to workers laid off or business firms injured because of tariff reductions. All these provisions should be stricken out. This discrimination cannot be justified. As chairman Mills of the House Ways and Means Committee asked: “Why should a worker who is out of a job due to import competition be placed in a more favorable light . . . than a worker who is unemployed due to cancellation of defense contracts . . . or technological advances?” It would be impossible to know, moreover, which plants shut down just because of import competition. As the First National City Bank of New York has pointed out: “Curtailments of operations in industry have multiple causes; import competition could almost always be figured as playing some part even though other causes might be paramount—shifting desires of consumers, bad management, exorbitant labor demands, or excessive taxes.”

3—Congress should provide that every trade agreement be subject to Congressional veto, but would automatically go into effect unless within 60 days after submission either House of Congress voted against it. This would be the same provision as that now in the Reorganization Act.

Finally, the Administration itself should adopt a consistent policy of freer trade. It should not try to impose punitive taxation on firms doing business abroad. As for our so-called “balance of payments” problem, it is caused solely by our own inflationary policies (combined with an inflexible exchange rate), and the first step to any cure is to halt these policies. Any other course (such as government speculation in foreign currencies) is a dubious gimmick that can only postpone the day of reckoning. ❁

## Richer by Less Work?

June 11, 1962

The demand of David Dubinsky, head of the International Ladies Garment Workers, and of George Meany, head of the AFL-CIO, for a cut in the standard

workweek from 40 to 35 hours is senseless from the workers’ point of view.

Without overtime, it would reduce national production by one-eighth, or 12½ percent. Therefore it would reduce real income and “purchasing power” by 12½ percent. If wage rates were not changed to compensate, it would reduce the money-wages of all presently employed workers by 12½ percent. It would *not* force the employment of 14.3 percent more workers, if only because there are not that many unemployed. Moreover, the percentage of unemployment is different in every industry and locality. Even if the cut in the workweek did force the employment of presently idle workers, presently employed workers would in effect be paying their wages.

That is why the union leaders insist that there must be a compensating hourly wage increase to bring present workers the same take-home pay. This wage increase would have to be more than 14 percent per hour. Putting aside the question of how the union leaders propose to achieve this uniform hourly increase—by law, by Presidential directive, or by individual strikes and “collective bargaining,” the result of achieving it would be to bring on massive unemployment. If, to remedy this unemployment, union leaders demanded enough monetary inflation to raise prices also by some 14 percent, the present workers would in effect take a cut in real weekly wages of 12½ percent.

### CRUDE FALLACIES

The union leaders’ demand, in brief, rests on the crudest fallacies. It assumes that there is only a fixed amount of work to be done, and that hours per person must be cut to spread this fixed amount of work around. The union leaders refuse to recognize that even our present unemployment is caused by excessive hourly wage rates in certain lines. The *reductio ad absurdum* has been put forward by Walter Reuther, who suggests that the greater the percentage of unemployment, the more the workweek must be cut and overtime rates doubled to compensate. This would make the unemployment greater and greater.

Administration officials have called attention to some of the absurdities in the proposal. Walter Heller, chairman of the President’s Council of Economic Advisers, points out it would “undercut the sources of economic growth quite apart from the cost-push effect that this would have on prices.” Secretary Goldberg declares: “The result would be that our goods would be necessarily higher priced, would be less competitive both at home and abroad, and the result would be more unemployment instead of less.”

## REVISE LABOR LAW

Other Administration officials make additional points: (1) A reduction of working hours of skilled labor would not spread work to unemployed that are not skilled. (2) When the workweek is shortened below 40 hours, many workers “moonlight”—i.e., go out and get a second job. (3) There is no evidence that a workweek of less than 40 hours increases efficiency. (4) In three-shift industries it is easier to schedule workers on an eight-hour day than on a seven-hour day, which is what the 35-hour week comes to.

But it is not enough to point out that a further forced 12½ percent cut in the standard workweek would be senseless from the workers’ point of view. Unions have the government-granted powers and immunities to force such cuts. The Ladies Garment Workers already have a 35-hour week. Electrical workers of New York City have forced a basic 25-hour week at \$4.96 an hour and \$7.44 for overtime. The situation will grow steadily worse (hurting workers most of all) unless we reconsider our labor legislation of the last 30 years.

Two revisions are basic. (1) We must stop *compelling* employers to “bargain” with specified unions no matter how exorbitant their demands. (2) We must stop allowing unions to enforce a strike by violence or the intimidation of mass picketing. This means revision of the Wagner-Taft-Hartley Act and of the Norris-LaGuardia Act. ☼

## To Rebuild Confidence

June 18, 1962

When tens of thousands of investors buy and sell millions of shares, each for his own reasons, no one can say with certainty what specific considerations caused the rise or fall. If more than one factor is involved, which invariably happens, no one can know the precise effect of each factor. But whenever the market has a violent rise or fall it is usually possible to make a few reasonable presumptions. Two main factors seem responsible for the recent crash.

The first was the overvaluation of most shares based on the assumption of rapid and inevitable “growth,” plus the assumption of further inflation. And even though both the inflation and the growth were probable, stocks selling at an average of 23 times earnings (as compared with 11.2 to 14 times earnings in 1954–1957) got too far beyond reasonable expectations. At some time a readjustment was inevitable.

But what triggered that readjustment, and made it far more violent than otherwise, was the President’s

“cold-fury” press conference of April 11, denouncing the steel price increase as “unjustifiable and irresponsible,” and ordering punitive measures against it. That action was part of a whole package of policies injurious to business. It was a culminating episode that shook confidence profoundly because it left all businessmen wondering whether they would be allowed to announce price changes or whether everything was to be decided by the President’s personal opinion.

## FIVE MEASURES

What can be done now to rebuild confidence? In this column of May 14, under the title, “To Restore Confidence,” I suggested seven measures. Let us consider a few such measures again with a different emphasis:

1—The President should abandon all hints that price and wage controls may be desirable or necessary unless labor and management act (in his judgment) “responsibly.”

2—He must also abandon the notion, sold to him by his Council of Economic Advisers, that they have discovered some “scientific” formula for fixing prices and wages. The idea that such a formula is a 3-percent boost in wage rates every year, with a tight ceiling on prices, is dangerous nonsense. Free markets and free competition can decide this enormously complicated problem, not bureaucrats too cocky to understand the superficiality and pitfalls of their formula. Pushing up wage costs while holding down prices is hardly the best way to create business confidence.

Many other measures that shake confidence ought to be withdrawn or repealed. I discussed some of these in the column of May 14, but several positive measures are possible to instill confidence:

3—Faster depreciation write-off should be permitted. The proposed 8-percent tax credit is a subsidy and a needless gimmick. But a 30 or 40 percent initial write-off of new investments in the first year and short write-off terms thereafter could prove a simple and dramatic incentive.

4—Faster write-offs are not a subsidy, but though in the long run they would increase government revenue, they are equivalent to a slight tax rate cut. This and other tax cuts are desirable. One would be to keep the 52 percent corporate income tax only on retained earnings, and to tax at only 50 percent (i.e., a reduction of 2 percentage points) all dividends paid out. This would reduce the inexcusably heavy double taxation on corporate dividends. In addition, all personal income-tax rates above 65 percent should be dropped to that level, *now*. The result of these measures would be a probable

long-run gain in government revenue, and a certain long-run gain in investment and production.

5—It is incredible that in a violently falling market the Federal Reserve should have kept margin requirements at 70 percent. As G. Keith Funston, president of the New York Stock Exchange, said in 1957: "I sometimes wonder at our sense of proportion. A man can borrow up to 75 percent to buy a car, 100 percent to buy a washing machine, and 94 percent to buy a home. But he can borrow only 30 percent to buy an interest in the company that makes the car, the washing machine or the house. We have made it much easier to borrow in order to spend, than to borrow in order to save." ❁

## Tax Reform Now

June 25, 1962

The Administration is to be congratulated for recognizing that tax reform and a reduction of the total burden of taxes are imperative if we wish to reduce the deterrents to production. But the Administration refuses to consider the reversals in its policies and attitudes that would be necessary to put these reforms into effect. At the moment, it is suffering from schizophrenia. It has begun to talk about a new tax-reform and tax-reduction bill for 1963. But it still insists that Congress must go through with the tax bill now before it. This is as if Mr. Kennedy were to say: "Before you consider a tax bill to restore business confidence you must first of all pass the existing bill that tends to undermine it."

### TO RESTORE CONFIDENCE

Business confidence needs to be restored now, as quickly as possible. A big step in this direction could be taken if the Administration abandoned several features of the existing tax bill and agreed to some changes it is talking about for next year:

1—Congress should abandon, or postpone for further study, the proposal for tax withholding on interest and dividends. This has been correctly described as "impractical, unnecessary, and unwise." It would create an administrative nightmare both for business and the government.

2—The Administration should abandon its proposals for punitive taxation of income from sources abroad. These proposals would force American companies operating abroad to bear simultaneously the full weight of foreign taxes plus the extra weight of higher U.S. income taxes. Prof. Dan Throop Smith of Harvard has characterized this section of the bill as bad in principle and raising administrative problems "which are

little short of appalling." The June monthly letter of the First National City Bank of New York presents an excellent analysis of the harmful features both of the tax-withholding and foreign-income provisions of the present tax bill.

3—The consensus outside of Administration circles is that the proposed 8 percent investment tax credit is too complicated, inequitable as between various types of business, and a doubtful long-run incentive to investment, especially because of the "compensating" tax revenues the government asks for. It would be far simpler, fairer, and more stimulating to investment to allow a depreciation write-off of, say 30 or 40 percent in the first year, or to write faster depreciation schedules into law, as in Canada.

4—The tax burden on corporations is excessive, and a deterrent to investment and production. At least one reform would be possible immediately. This would be to keep the 52 percent corporate income tax only on retained earnings, and to tax at only 50 percent all dividends paid out. As dividends when received are also taxed as personal income, they are subject to a double taxation that is a drastic discouragement to investment and economic growth. The differential should eventually be much greater than the 2 percentage points here suggested. But at least the principle of differential tax rates on retained and distributed corporate earnings should be established now. If this were substituted for the present \$50 dividend exclusion in the personal income tax and the 4 percent tax credit against dividends received it would mean no net loss in government revenues.

5—All personal income-tax rates in excess of 65 percent should be dropped to that level now. This would mean practically no loss in government revenues. In fact, even if the top rates stopped at 50 percent there would almost certainly be a net long-run gain in government revenues. But this would be far less important than the stimulus this change would give to production and investment.

These changes in the tax laws would reduce immediate tax revenues very little, and long-run tax revenues not at all. But their moral effect would be immediate. They would reassure business and stimulate investment. This stimulating effect will not be achieved by tax cuts merely designed to create budget deficits and more inflation, nor will it be achieved by the deplorable kind of speech Mr. Kennedy made at Yale, contemptuously dismissing all criticism of his policies as "worn-out slogans" based on "myths." ❁



## Catechism on Taxes

July 2, 1962

*Do we need a tax cut now?* Yes. *Why?* Because the burden of taxation on investment is excessive and undermines incentives. Also, because of the stock-market collapse, a tax cut now is psychologically important.

*What taxes should be cut? How much?* Those taxes should be cut that most discourage production and investment. We should begin with corporation taxes. First, we should abandon the ill-advised proposals to discriminate against American business investments abroad. For an immediate positive stimulus, a depreciation write-off of, say, 35 percent should be allowed on all investments in the first year, with short total write-off periods. The corporate income tax of 52 percent should be kept only on earnings retained in the business. What a corporation pays out in dividends should be taxed at a lower rate—to begin with, not more than 50 percent. This lower tax on earnings paid out as dividends could be a substitute for the present complex personal \$50 allowance and 4 percent credit on dividends.

*How much would these reductions reduce government revenues?* In the first year or two, perhaps a little. In subsequent years, not at all. They would increase government revenues by their incentives to new income-producing investment, employment, and production.

### CUT SPENDING TOO

*Would such tax cuts be enough to give the stimulus needed?* No; but they are the best possible until real slashes are made in the huge proposed government spending of \$92.5 billion in fiscal 1963 (\$115 billion counting social security). For the following fiscal year, given a few moderate spending cuts, corporate tax rates might be dropped to 50 percent for retained earnings and to 45 percent for earnings paid out in dividends.

*What about personal taxes?* Income taxes ought to stop right now at a top rate of 65 percent, instead of soaring to a confiscatory 91 percent.

*Wouldn't that lose revenue?* It would probably increase revenue, even in the first year; and certainly in later years. Even if the top rates stopped at 50 percent, the government would lose, at most, a hypothetical amount of less than \$1 billion, which is what it now spends in three or four days. In fact, however, even if top rates on personal incomes (keeping other brackets unchanged) stopped at 50 percent, there would be a long-run increase in government revenues—and a dramatic increase in investment and production.

*But what about personal income taxes on the lower brackets?* It is desirable to reduce tax rates all down

the line; but lower rates on lower and middle incomes would mean a very heavy loss in revenues. Such tax cuts are possible only by heavy cuts in government spending.

### REAL INFLATION THREAT

*With our huge defense needs, are such spending cuts possible?* Easily. More than half of our planned \$115 billion spending for fiscal 1963 is for non-defense items. To slash foreign aid, farm price supports, etc., would strengthen our economy.

*Isn't the real need now to cut taxes on lower and middle incomes to give a big fillip to "purchasing power"?* No; that would only lead to bigger deficits and inflation.

*But isn't the whole inflation danger over, as so many people are now writing and saying?* No. With a \$7 billion deficit in the fiscal year just ending, and with an increase of \$16 billion in money and deposits in the last twelve months, plus the prospect of a further big deficit in 1963, the danger of more inflation is very real.

*What of the drop in the stock market, and steady commodity prices?* In the midst of every inflation (even the tremendous German inflation of 1923–24) there are occasional violent breaks in the stock market, because speculative guesses of the exact extent and pace of an inflation are constantly changing. The wholesale price index is held down for technical reasons that would take long to explain. But consumer prices have mounted to new high levels this year.

*What is the most serious threat of renewed inflation today?* Precisely the false assumption that "the danger of inflation is over" and that the country needs another shot in the arm. ❁

## Bipartisan Errors

July 9, 1962

What is most disheartening about Mr. Kennedy's reaction to the deepening crisis of confidence is his complete inability to admit past error or the possibility that he could be wrong. His Yale speech, implying that all criticism of his policies has been made up of "stale phrases," "myths," "illusion and platitude," "traditional labels and worn-out slogans," and that he alone is interested in "the *real* problems of our time," was not calculated to restore confidence but to undermine it further. He did not help matters when he said both before and after the House vote rejecting the farm bill that those who voted against it (including 48 Democrats) did so because they "chose to make a party issue of this matter instead of voting in the national interest."



The truth is that the farm bill demanded by Mr. Kennedy and Secretary Freeman was incredibly bad. It was disgraceful that it passed the Senate. It should have been defeated in both houses by an overwhelming vote. It would have imposed the worst regimentation in our history on the growing of wheat, corn, and other grains, with Draconian economic punishment against any farmers who dared to violate its provisions.

### FARM FIASCO

Eisenhower's broadside against the whole Kennedy economic program contained many a truth. Its central truth was that the present Administration's difficulty stems "primarily from an inadequate understanding of our American system—of how it really works." But Eisenhower's own remarks were marred by partisanship. For the misconceptions and bad policies he attacked were only exaggerations of unsound policies accepted in his own Administration.

The policy of farm price supports, overstimulating production and creating unsalable surpluses, plus the attempt to offset these consequences by acreage and marketing controls, began in the Roosevelt New Deal. But it was continued by the Truman and Eisenhower administrations, with ever-mounting problems, because neither they nor successive Congresses had the courage to stop it. The economic problem is not at all baffling. The situation can be cured by abandoning and reversing the policies that created it. It is merely necessary to halt all further price supports; and to sell the surpluses back to the farmers themselves, on a pro rata basis, below the free-world price, leaving it to the individual farmer to decide whether to hold or resell, and how much to plant under the new conditions. But neither party has had the courage to suggest anything like this. So the problem mounts.

### CANADIAN CRISIS

This applies also to the stockpiling program. Democratic investigators seem chiefly eager to expose Republican errors. But the policy was and is bipartisan. On Jan. 31, Mr. Kennedy advised that the Federal stockpile of strategic materials be reduced, but as Senator Byrd has pointed out, the \$8.7 billion figure of Feb. 1 actually increased by the end of March.

The 26 budget deficits and the inflation of the last 32 years have also been bipartisan. All that Mr. Kennedy and his advisers have added is the doctrine that deficits are often necessary and "appropriate." As a result of similar policies Canada has just had an exchange crisis. Part of its countermeasures—to cut government spending and to raise the discount rate—are correct. But the added duties on imports, and the borrowing of more U.S. dollars from us and from the

International Monetary Fund, are at our expense, and will only intensify our own balance-of-payments problem. Yet the whole IMF monetary system, now stumbling to a crisis, has bipartisan support.

And so with a whole series of other policies—excessive taxation on corporations, double taxation of dividends, niggardly depreciation allowances, confiscatory rates on higher personal incomes, business prosecution under unpredictable interpretations of vague anti-trust laws, and Federal labor laws that encourage union demands and strikes to get out of hand.

These bipartisan errors, many of them of more than 30 years' standing, are having cumulative evil consequences. Will either party have the courage, before it is too late, to reexamine or repudiate them? ❁

## Deficits Forever?

July 16, 1962

For the fiscal year just closed the Federal government reported a deficit of more than \$7 billion. Nobody but Senator Byrd seemed to be particularly concerned. Only an insignificant minority in Congress or out was demanding a cut in expenditures. Almost everybody, including congressmen, governors, labor unions, chambers of commerce, was calling for a cut in taxes.

We are losing the very concept of a responsible budget. Consider the strange record of estimates for the fiscal year just closed. In January 1961, the Eisenhower Administration estimated that it would end with a surplus of \$1.5 billion. On March 24, 1961, the Kennedy Administration declared that this was unrealistic, and forecast a deficit of \$2.1 billion. On May 25, 1961, it raised this deficit estimate to \$3.5 billion. On July 25, 1961, it raised its deficit estimate again to more than \$5.3 billion; on Oct. 29 again to \$6.9 billion; on Jan. 18 of this year to \$7 billion.

### 26 IN 32 YEARS

Also last January, the President estimated that there would be a surplus in the fiscal year that has just begun of \$463 million. No one today takes this estimate seriously. Responsible Congressional committees think there will be a deficit of \$3 billion to \$5 billion. The Administration blames the changed outlook on an unexpected change in business conditions. But the estimate never was realistic. Its revenue forecasts were based on the expectation of unparalleled prosperity. With no important net change in tax rates, revenues were counted on to jump from \$82.1 billion in fiscal 1962 to \$93 billion in fiscal 1963. If revenues do not

increase, and expenditures are as estimated, the predicted surplus of half a billion will become a deficit of \$10.4 billion.

But what of the expenditure side? In May, Senator Byrd pointed out that “some 200 actions and proposals involving increased obligation of public money and credit can be documented in Presidential communications to Congress during the current Administration.” Since then the President has hardly let a week go by without presenting some new major spending proposal. Nothing is said about the effect on total proposed expenditures for the year. These proposals are not accompanied by a revised budget, let alone by any compensating tax increase.

In sum, the outlook is already for a deficit for fiscal 1963 approaching the dimensions of that for the year just closed. We have now had 26 deficits in the past 32 years. We face a 27th.

### RATIONALIZATIONS

Instead of showing any concern about this, the Administration has been developing rationalizations that would logically call for perpetual deficits. It began to talk of balancing the budget over “the business cycle” rather than annually. Now Budget Director Bell tells us that even this is “clearly inadequate to deal with a situation such as we have been experiencing for the last five years—a situation in which we have had years of recession clearly enough, but no years of full prosperity.” Whereas “deficits, not balances, are appropriate in years of recession,” and even bring “positive benefits,” there is always, even in a good year, “real danger that the attempt to achieve a budget balance too soon may itself contribute to bringing the recovery to a halt below full employment levels.” The natural conclusion to be drawn is that the only safe policy is one of perpetual deficits.

What must be the effect on foreign confidence in the dollar when, on top of all this, demands are coming from all sides for an immediate cut in taxes, many of them for tax cuts on lower and middle personal incomes in order to “pump more purchasing power” into the economy and insure a thumping inflationary deficit?

The situation raises a grave problem for believers in fiscal responsibility. Tax cuts on productive enterprise *are* needed, for the sound reason that present taxes are discouraging production and new investment. But those who ask for such cuts must insist on the condition that even greater cuts be made in our fantastically swollen expenditures. Must we wait, like Canada, until a currency crisis is upon us before we start to put our house in order? ❁

## Controls and Corruption

July 23, 1962

Since 1934 this country has subjected all sugar imports to a complicated quota system under which each country is allowed to export to us no more than a fixed maximum each year. For such imports the U.S. has been paying a special premium of 2.8 cents a pound above the world price. When this program was altered drastically in 1960 by President Eisenhower’s decision to cut off purchases of Cuban sugar, which had totaled more than two-thirds of the whole U.S. import quota, increased shares were temporarily allotted to other Latin American countries.

The Sugar Act expired June 30. Early this year, President Kennedy wisely requested that the quota system be abandoned on the ground that competition among nations for quota shares often produced ill feeling toward the U.S. He could have recommended that sugar imports be treated like any other imports by converting the 2.8 cents a pound premium payment into a flat tariff for the time being, and otherwise leaving the total of sugar imports and the amount from each country to be settled by the free play of supply and demand and competition. Instead, he suggested a complicated substitute plan still entangled with foreign subsidies.

### U.S. AS SUGAR DADDY

The bill that Congress actually passed retained the quota and premium systems. It provided for an increase of the sugar market for domestic producers from 55 to 60 percent, an import quota of 1,205,000 tons divided among 27 countries, plus a special treaty allocation for the Philippines, and a reduction of 10 percent annually in the premium payments. Immediately there was an outcry from the Dominican Republic that the cut in its sugar quota would lead to economic collapse and political upheaval. So the Senate tacked an amendment on to another bill giving the President discretionary power to increase the quotas of the Dominican Republic, Argentina, and Peru over the next three years.

Then a sudden protest came from senators against the practice of foreign governments in lobbying for bigger import quotas for their own countries. It was brought out that 23 countries seeking sugar quotas were represented by Washington lobbyists. All this was denounced as very wicked. But as these individual quotas are necessarily arbitrary, and set openly on a basis of political favoritism, what did Congress expect? Arbitrary quotas must breed lobbies.

### PRIVILEGED ACRES

That government “planning” leads to lobbying, to favor-seeking, and finally to corruption, is even more strikingly illustrated with regard to our wholly home-grown crops. On July 2 the General Accounting Office reported to Congress that cotton brokers acting as agents for the government had made illegal profits by selling to themselves more than \$400 million worth of government cotton at prices far below the prevailing market. On July 4 it was revealed that two county office managers for the Department of Agriculture had been suspended as a result of a Federal investigation into the alleged sale of Federal rice planting allotments in Texas. On July 6 two Federal farm officials from Oklahoma admitted to a Senate subcommittee that they had each accepted \$820 in cash from Billie Sol Estes.

This is probably a prelude to more revelations. Bribery and corruption are an almost inevitable outcome of arbitrary government controls.

The steps are simple. The government, say, guarantees farmers higher prices for certain crops than they could get in a free competitive market. As a result it finds that it has encouraged huge surpluses. To prevent these it limits the number of acres on which each farmer is permitted to grow the subsidized crops. But these privileged acres then sell for enormously higher prices than those on which the subsidized crops are forbidden. So what happens when someone stands to win or lose millions of dollars, depending on the discretionary decision of some petty bureaucrat getting \$5,070 or \$7,275 a year? The result is the most inevitable consequence of substituting discretionary favoritism for the rule of law. One of the worst consequences of “government economic planning” all over the world has been the corruption of the civil service. ❁

## Is Inflation the Cure?

July 30, 1962

The chief economic problem of this country in the last generation has been inflation. This is reflected in 26 deficits in the last 32 years; in a growth of the national debt from \$16 billion in 1930 to \$298 billion today; in a fourfold expansion of the money supply—from total bank deposits and currency of \$68 billion at the end of 1939 to \$282 billion today; and in a fall in the purchasing power of the dollar to less than half of its 1939 level.

We cannot throw all this into the past tense. In the fiscal year just closed there was a deficit of \$6.3 billion. When the Treasury announced the new depreciation schedules for business, it estimated that the changes

would mean a tax cut of \$1.5 billion in the first year. But Senator Byrd had already estimated a probable deficit in the current fiscal year of \$6 billion. One more item: This year consumer prices have risen nearly every month to a new high level.

### BALANCE OF PAYMENTS

The problem that has been worrying government authorities for more than four years has been the deficit in the country's balance of payments. This amounted to \$3.5 billion in 1958, to \$3.7 billion in 1959, to \$3.9 billion in 1960, and to \$2.4 billion in 1961. So far this year, according to a recent statement of Treasury officials, the deficit has been running at a rate of “only” \$1 billion to \$1.5 billion a year. But this is no ground for complacency. For the deficit is *cumulative*. The latest figures mean that it has totaled \$14 billion in the last four and a half years. This is reflected in a rise in short-term liabilities to foreigners to more than \$23 billion, and in a constant fall in our gold reserves, now down to \$16.3 billion, the lowest level in 33 years.

This deficit in the balance of payments is being treated by our officials as if it were the *cause* of our difficulties. It is in fact the *consequence* of our policies. The real evil is our inflation. This is the cause of the deficit in the balance of payments. For it raises our costs and prices to a point where we can compete less successfully with foreign producers. It makes this country less attractive to buy from and easier to sell to. In addition, our artificially low interest rates make it less profitable for foreigners to invest funds here and more profitable for Americans to invest funds abroad. Finally, gold at \$35 an ounce (almost the only thing that hasn't risen in price in 28 years) seems to many foreigners the biggest bargain we have to offer.

### A SLASH IN SPENDING

The problem, to repeat, is inflation. Yet almost everybody has suddenly begun to talk as if the problem were not enough inflation. Almost everybody has begun to demand a tax cut. And most of those who demand the tax cut want it in order to make sure that we will have a thumping deficit in the current year. The deficit of \$7 billion in the year just closed is being ignored; so is the prospect of a \$6 billion deficit this year, even without a tax cut. Because of the political hazards of asking for a tax cut, the Administration is reported to be looking into the possibilities of speeding up Federal spending as an alternative.

The great fear is that the next deficit may not be big enough. The theory is that we need to pump more “purchasing power,” i.e., more money, into the economy. The theory, in brief, is that we need another dose of inflation.



The country, in other words, is still bewitched by the Keynesian fallacies, still enchanted with inflation. Do we (even though employment is at record levels) have more unemployment than we like? Then let nobody ask whether excessive wage rates in certain lines might be causing it. Let's soak up all the unemployment by printing more money, by raising everybody's cost of living. And let's ignore the desperate need of maintaining confidence in the dollar.

The irony is that we do need a substantial tax cut to relieve the excessive burdens on and discouragements to production and investment. But accompanying that cut we need an even greater slash in government spending if we are to keep our economy sound and vigorous and free. But a major slash in our hysterical spending is something of which no one in politics now dares to speak. ❁

## The Welfare Mess

August 6, 1962

When the Senate rejected President Kennedy's Medical Care for the Aged bill by the narrow vote of 52 to 48, he denounced the vote as "a most serious defeat for every American family. . . . We have to decide," he continued, "the United States, in 1962, in November, in the Congressional elections, whether we want to stand still or whether we want to support this kind of legislation for the benefit of the people."

Was the defeat of the medicare bill a defeat, or was it really a victory, for most American families? May it not at least be better to "stand still" for a while than to keep going in the wrong direction—further and further away from individual initiative and self-help, and deeper and deeper into the paternalistic welfare state?

How deep we have already got into the welfare state is documented in the July monthly letter of the First National Bank of New York. In a tabular comparison of public social-welfare expenditures in the fiscal years 1950 and 1961, the bank's letter shows that old-age, survivors, and disability insurance payments rose from \$784 million in 1950 to \$12,160 million in 1961, an increase of 1,451 percent. Unemployment benefits rose to nearly \$4 billion, an increase of 67 percent. Old-age assistance payments rose to nearly \$2 billion, an increase of 33 percent. Aid to dependent children increased 115 percent, hospital and medical care costs 106 percent, government spending on medical research 827 percent, veterans compensation and pensions (at nearly \$4 billion) 34 percent. Altogether, total public-welfare expenditures grew from \$13.8 billion in 1950 to \$37.3 billion in 1961, an increase of 170 percent.

## LIMIT TO TAXES

This tremendous total does not include such welfare-related activities as farm-price supports, urban renewal, aid to depressed areas, etc.

The money to pay these gigantic welfare benefits did not come out of some magical fourth dimension. It came out of taxes—nearly half out of a flat tax on payrolls. If the employer's contribution is considered to be in lieu of higher pay for the worker (as in the long run it must be) the tax on the workers is now at 6¼ percent. The combined tax is now scheduled to rise to 7¼ percent next year, to 8¼ percent in 1966, and to 9¼ percent in 1968. The President's medicare program, if enacted, would add another ½ of 1 percent. Yet even Secretary Ribicoff declared last February: "I think we have reached a stage of almost maximum taxation under social security. In my mind, I place that at 10 percent of payroll."

## MOUNTING ABUSES

Rates have to be raised to keep the program solvent. But it is a real question whether presently scheduled rates are high enough to do this. No serious thought is given to the enormous "unfunded liabilities" already assumed by the social-security program. Official actuaries have placed these at \$350 billion. One former actuary places them at \$650 billion.

Yet hardly a week goes by in which a further piling up of liabilities is not recommended. Several Administration proposals would "liberalize" unemployment insurance further.

In the last year or so, reports of abuses and scandals in the welfare programs have been mounting. The bank letter cites a few. From Hollywood, it was reported that a child actor, who turned down a job paying up to \$28 a day because he was accustomed to \$100–\$150 a day, was awarded unemployment benefits. In New York, a ring of six persons was uncovered which allegedly had bilked the public of \$41,900 in unemployment compensation by faking employment records. A committee of the New Jersey legislature discovered a family with 23 children that was receiving \$969 a month in welfare payments (including social security).

It is obvious that handing out generous welfare benefits to idle people while imposing heavy tax burdens on those who work and produce can only discourage ambition and responsibility, work, production, and economic growth. The President's medicare program would give heavy (unearned) benefits to the present aged and load the cost onto the present young.

The whole social-security system is in urgent need of reexamination. ❁



## Assurance vs. Acts

August 13, 1962

In his press conference of July 23 the President announced that “those who speculate against the dollar are going to lose. The United States will not devalue its dollar.” The effect was dramatic. Gold-mining shares fell. The dollar was stronger on the foreign exchanges.

It was gratifying to have this assurance reiterated. But Mr. Kennedy gave this same assurance in his first month in office and it is necessary to point out once more that the dollar cannot be defended merely by uttering the right phrases. These must be followed by actions and policies which will convince the world that such pledges can and will be kept.

The right policies have not followed the right words. The Administration has been pursuing a policy of deficits and cheap money. The outward flow of gold has continued. Three days after the President's pledge of July 23 the Treasury announced a further weekly loss of \$90 million, bringing the nation's supply of monetary gold down to \$16.2 billion, the lowest in 23 years. Against this our short-term liabilities to foreigners and international institutions total \$23 billion.

Yet in the same week in which Mr. Kennedy made his renewed assurance he let it be known that he favored a tax cut of “at least \$7 billion a year.” As a deficit of some \$3 billion to \$6 billion is already in prospect, this could mean a total deficit of \$10 billion to \$13 billion.

### INFLATION THE CAUSE

Now the blunt truth, as I pointed out in this column of Dec. 4, 1961, and on other occasions, is that our balance-of-payments deficit is simply the consequence of our internal inflation. No matter what solution we adopt for our dollar problem, the first and indispensable step is to halt this inflation. Yet not only the Administration, but the greater part of the business and banking community, has been treating this problem either with astonishing lack of understanding or with disturbing levity. One of the country's outstanding business organizations has been advocating a big slash in taxes without a corresponding slash in expenditures.

Two exceptions to this irresponsible attitude deserve honorable mention. Last November Hans A. Widenmann, a partner in Carl M. Loeb, Rhoades & Co., pointed out that the only solution to the dollar problem was to “balance our budget and put an end to inflationary trends.” Anything else was a mere “gimmick.” He listed eleven such gimmicks that the Administration had already tried or suggested—from reducing tourist duty-free imports to \$100 and the proposal to eliminate the 25 percent gold-reserve requirement to attempts to

“improve liquidity” through the International Monetary Fund. And he showed that each of these gimmicks was at best a stopgap, and that some would mean dangerous steps in the direction of more world inflation.

### UNDERMINING THE DOLLAR

In May of this year, John Exter, senior vice president of the First National City Bank of New York, made a brilliant analysis of the cause of the dollar crisis. He stated his conclusions bluntly: “A balance-of-payments deficit is caused by monetary policy alone. It is a question of creating too much money . . . of running the printing presses. If one country runs its printing presses faster than other countries run theirs—remember Gresham's Law—then that country is going to have a balance-of-payments deficit.” He went on, like Widenmann, to list the gimmicks to which the Administration had resorted to solve the problem, and pointed out that they enabled us at best to postpone it. “Why do we continue easy money when it becomes clearer day by day that it is relentlessly undermining the dollar?”

If I may presume to answer his question, I should say: Because we are still under the delusions of Keynesianism and inflationism. Because we still think that economic salvation lies in government spending, in deficits, and in cheap money. Because many of us hold the insane belief that balanced budgets and sound money cause depression and unemployment. Because we have not stopped to ask ourselves how irreparable the damage would be if confidence were once undermined in the world's anchor currency—the dollar. ❁

## Socialism vs. Freedom

August 20, 1962

When some visiting Brazilian students interviewed the President one of them asked what the reaction of the U.S. Government would be “in the event we were to socialize the means of production in our country as a way to more effectively wage the battle against underdevelopment.”

Mr. Kennedy replied: “The decision of your country as to the means of providing progress is your decision, and if by socialization you mean ownership of the means of production or of the basic industries, that is a judgment which you must make. What we are opposed to is a denial of civil liberties, a denial of opportunities for people to assemble, to have their press, to make a free choice of what kind of government they want. . . . We prefer the competitive market economy here. We believe that by free competition we can satisfy

the needs of our people best. Every country must make its own choice.”

This reply, though ambiguous in some respects, reveals the ideology behind the Alliance for Progress and our foreign-aid program. A less diplomatic but more instructive reply might have run like this:

### WHICH SYSTEM WORKS?

Whatever you do in your country is of course your own business, whether it is voting yourself into socialism or voting yourself into a dictatorship, as the Germans did when they chose Hitler or the Argentinians when they accepted Perón. In either case we do not consider it our business to interfere, with either government economic aid or a “warning.” It is only fair to tell you, however, if you are asking our advice, that you will not accelerate your economic development or growth by socializing the means of production. You will, on the contrary, retard it—as your recent governments have in fact retarded it by all sorts of measures hostile not only to foreign investment but to domestic business.

We ourselves got to be the richest and most prosperous country in the world by following the way of free enterprise, of private ownership of the means of production—in a word, of capitalism. Our rate of economic growth was increased by private investment of foreign—chiefly British—capital here. It was attracted here not only because it could get a higher rate of return than at home, but because it ran no risk of discrimination, oppressive taxation, nationalization, or expropriation. It was welcomed, not feared. In the same way, today, the economic growth of Canada has been greatly accelerated by the investment of private United States capital.

### FREEDOM INDIVISIBLE

It is the anti-capitalistic mentality of the so-called underdeveloped countries that has kept them underdeveloped. It has scared away foreign private capital. It has also discouraged domestic investment. What you seem to be asking is whether, if Brazil socialized the means of production, we would be willing to pour in the American taxpayers’ money to help you do it. We would be even more foolish if we did that than you would be to socialize. For socialization would retard and distort your economic development. Our taxpayers would not only lose their money, but would be encouraging you to follow unsound and hurtful economic policies.

The question is not whether we North Americans “like” or “dislike” socialism; the question is whether socialism tends to increase or retard production of the goods consumers really want. Economic aid to a socialistic country is worse than wasted.

And now we come to the question of liberty. Capitalism is merely the name for a system of economic

liberty. Under it civil and political liberties flourish and are secure. Under a complete or nearly complete socialism neither economic nor political liberty can exist. Freedom is indivisible. How can there be freedom of press, speech, or assembly when the government owns all the newspapers, presses, and assembly halls? As Leon Trotsky (who knew) wrote in 1937: “In a country where the sole employer is the State, opposition means death by slow starvation: The old principle: Who does not work shall not eat, has been replaced by a new one: Who does not obey shall not eat.”

So if you want to go in for socialism, it’s your funeral. But don’t expect us to subsidize it. ☸

## Where We Are Going

August 27, 1962

The dollar is the world’s anchor currency. Nearly every other monetary unit is tied to it. It is difficult to estimate what the domestic and world repercussions would be if the dollar went off gold or were devalued.

Yet what is the outcome likely to be if our government continues the policies it has pursued, not only since Mr. Kennedy took office, but practically since the end of World War II?

In 1958, to go no further back, we had a deficit in our balance of payments of \$3.5 billion. In 1959 this deficit was \$3.7 billion; in 1960, \$3.9 billion; in 1961, \$2.5 billion. In the first half of the present year the deficit ran at an annual rate of \$1.5 billion.

This decline in the annual rate has been hailed by some commentators as very reassuring. But they forgot that the deficit is *cumulative*. Since the beginning of 1958 it has totaled \$15 billion, and is still increasing.

So we continue to lose gold while foreign claims against our remaining supply of it continue to grow. At the end of 1957 our stock of gold amounted to \$22.8 billion, and our total short-term liabilities to foreigners (including international institutions) to \$15.2 billion. Today the relation is reversed. Our short-term liabilities to foreigners now total \$23.5 billion while our gold stock is down to \$16.1 billion. In brief, our gold stock is already less than the total direct and indirect short-term foreign claims against it. True, our government is pledged to pay gold only against “official” foreign or international claims. But even these now reach \$15.1 billion.

### IF WE LOSE MORE GOLD

What is likely to happen if a deficit in the balance of payments, even at the present reduced rate, continues?

Against present note and deposit liabilities of \$47.4 billion, the Federal Reserve System is required to hold a gold reserve of 25 percent, i.e., of \$11.8 billion. This means that we now hold “free” gold reserves of only \$4.3 billion. What will happen if foreigners continue to ask for gold and even this narrow margin shrinks?

It is possible that foreign central banks, worried by the diminution of our “free” gold supply, may become nervous and precipitate a run. Fearful of this, the Kennedy Administration may renew its support of the proposal to abolish the 25 percent gold reserve requirement so as to “free” our entire gold stock for withdrawal. It is doubtful, however, that such a step (which would obviously shake *domestic* confidence in the dollar) would in fact reassure foreign holders; it might itself precipitate a run.

If the export of gold were suspended, nothing could prevent a violent drop of the dollar on the foreign-exchange markets. If an overnight devaluation of the dollar were announced—say by raising the price of gold from \$35 to \$70 an ounce—the step would be almost automatically followed by an equal devaluation of other currencies. This would probably be the signal for a new world inflation. But it would not cure our balance-of-payments problem—unless we stopped inflating faster than other countries.

### STOP THE INFLATION

Our balance-of-payments deficit, and the dwindling confidence in the dollar, are both consequences of the same cause—inflation. Because it raises our costs and prices, inflation makes this a better market to sell to and a poorer one to buy from. Our cheap-money policy makes it less attractive for foreigners to lend or invest here and more attractive for Americans to lend or invest abroad.

The indispensable step in any cure is to halt our inflation. This means that we must allow our interest rates to go up, stop expanding credit and printing money, slash government spending, and balance our budget.

The proposals in Mr. Kennedy’s television address of Aug. 13 were nearly all in the opposite direction. Of the six bills that he wants enacted immediately, one is a tax credit for new investment (which would be good considered in isolation), but four of the other five—for increased public works, “youth employment,” longer unemployment benefits, and education subsidies—involve still more Federal spending. They would increase the prospective deficit. Their enactment would further undermine confidence in the dollar. ❁

## A 49 Percent Top

September 3, 1962

The basic disagreement in all the recent dispute about a tax cut reduces itself to this: Should a tax cut be accompanied by at least a corresponding cut in expenditures, or not? For all parties to the debate agree on one thing: Present taxes are too high.

This was admirably put by President Kennedy in his television address of Aug. 13: “Our present tax system is a drag on economic recovery and economic growth, biting heavily into the purchasing power of every taxpayer and every consumer. . . . Our tax rates, in short, are so high as to weaken the very essence of the progress of a free society—the incentive for additional return for additional effort.”

In this statement lies the key to the kind of tax cut most likely to provide incentives and stimulate economic growth. It is a reduction of the exorbitant tax rates on productive enterprise and on the higher incomes.

The rates on personal income now range from 20 to 91 percent. A cut in the 20 percent rate to 15 percent, now widely advocated, would result in a serious loss of government revenues. Such a 25 percent cut in the basic rate would probably reduce the yield from personal income taxes by nearly the same percentage. But the case would be obviously different in the rates ranging from 50 percent up to 91 percent.

### MONEY FOR THREE DAYS

All the income-tax rates above 50 percent, in fact, today yield a revenue of less than \$1 billion—or no more than the Federal government now spends every three or four days. To halt the progression of the personal income-tax rates at 50 percent would restore, to the most productive element in the country, “the incentive for additional return for additional effort.” Not only would there be no significant loss of government revenues but probably a very substantial increase. Much more important, such a reform would mean an increase in national output and income, and in the rate of economic growth.

In Sweden, some years ago, a prominent industrialist said to me: “We in Sweden consider any tax rate over 50 percent to be confiscatory.” It seemed a good rule of thumb. If we want to make it more precise, there would be a clear practical and psychological advantage in setting the top personal income-tax rate at 49 percent. For then every taxpayer would feel, in considering a new venture, a new investment, or added personal effort, that he could count on keeping “most” of what he earned.

Many readers, long accustomed to our present confiscatory rates on higher incomes, may be shocked by



any proposal to cut these down to a top rate of 49 percent without at the same time making a corresponding cut in the rates on lower incomes. Certainly there is a strong case for reducing these rates too—when and if expenditures are also cut enough to make this possible without unbalancing the budget.

#### FOUR REASONS WHY

But the case for an immediate cut in the tax rates above 49 percent, even without other tax reductions, is fourfold: (1) The rates between 50 and 91 percent do not in fact produce revenue, but reduce it. (2) The rates above 50 percent discourage effort and investment and reduce employment and economic growth. (3) These rates encourage many voters to tolerate government extravagance under the illusion (and the figures show that it is an illusion) that only “the rich” are paying for it. (4) The rates are grossly discriminatory and inequitable. They serve no purpose except to gratify envy and malice.

Some economists, in fact, are now coming back to the view that it is hard to justify, either on grounds of justice, revenue production, or economic growth, anything but a simple proportional or flat rate of income tax. Do 90 percent of the voters have a right to impose discriminatory and punitive taxes on the other 10 percent? Prof. Milton Friedman of the University of Chicago has calculated that a flat tax of 23½ percent on taxable income, as presently defined, would yield as much revenue as the present highly graduated rate.

To halt the present tax progression at a top rate of 49 percent would increase government revenues, restore business confidence, and increase economic growth at one simple stroke. ❁

## Overregulation

September 10, 1962

Everything possible must be done to prevent a recurrence of the kind of tragedy brought about by thalidomide, a sleeping pill that, when taken by pregnant women, was found to have the frightful side effect of causing deformity in infants.

Stricter legal controls are no doubt part of the answer. And yet they may also bring with them the danger of an overregulation that may itself have the side effect of retarding medical progress without being more than partially effective in curing the evil against which it is aimed.

Take the drug-control bill in the form in which it was unanimously passed by the Senate. If such a bill

had already been law, could it have averted the thalidomide tragedy? Would such a law give assurance that no similar tragedy could occur again?

One answer to these questions is that even under existing law Dr. Frances Kelsey did have authority to keep thalidomide off the market and exercised it. What is ironic, as one scientist has put it, is that the real tragedy occurred in Germany (where the drug originated), “a country that has no drug laws that would have prevented it,” and yet it is the U.S. that “takes immediate action to drastically change the strong drug laws it has which actually had prevented that tragedy from occurring here.”

#### MUST TEST ON MAN

One of the provisions of the Senate bill gives the Secretary of Health, Education, and Welfare discretionary authority to require that new drugs be tested first on animals. Most pharmaceutical firms already make such tests. But an irony of the thalidomide case is that no tests on animals showed the dreadful side effect that developed in pregnant women. Soon or late, a new drug must be tested on human beings. And no one can know in advance what side effects will develop, or in what number of cases, or how long after the drug is taken.

Some of the provisions in the Senate bill could do more harm than good. Among the most serious are those giving the Food and Drug Administration the right to pass on the “efficacy” of new drugs and not merely, as heretofore, on their safety. More than this, the bill puts the burden of proof on the industry rather than on the government. It requires “substantial evidence” that a drug is effective before permitting it on the market. It is a dangerous legal precedent to allow any bureaucrat to keep off the market something that, even though harmless, is in his opinion “ineffective.” This is trying to protect the patient against the judgment of his doctor, trying to protect the consumer against his own judgment. Efficacy can be determined only by freedom of trial, and in no other way.

#### PROFITS AND PROGRESS

Present legal provisions give the government power to prevent the marketing only of unsafe drugs. They permit a new drug to be marketed if the government takes no action within 60 days after an application is filed. This seems much sounder in principle than provisions that allow a government official to hold up a drug indefinitely until the manufacturer can prove to the official’s satisfaction that it is not only safe but “effective.” This could give a bureaucrat power of life or death over a company.



It is fortunate that the Senate threw out proposed amendments to abridge drug patent rights. Those who sincerely want the American consumer to benefit from more miracle drugs will not begrudge the drug industry its profits. They will want the industry to have maximum incentive to develop new drugs. Sterling Drug, Inc., estimates that already each new drug that reaches the market costs the company an average of \$5 million in development costs. Such great sums must come from somewhere. They can only come out of past or prospective profits. Initial high profit margins are the greatest stimulus to expansion of the industry and the entry of new firms. This expansion increases output, stimulates further research, and brings down prices.

It would be tragic if we hastily passed laws whose chief effect was not to safeguard the health of the American public but to slow down the very medical progress that in the last generation has extended the span of life and almost eradicated some of the most dreaded diseases of mankind. ❁

## The Basis of Economics

September 17, 1962

The new book by Prof. Ludwig von Mises, *The Ultimate Foundation of Economic Science* (148 pages, Van Nostrand, \$4.50), is what its title implies—a basic investigation not only of the methods appropriate to economics but of how we can discover and prove its fundamental truths and propositions.

His theme might be stated negatively. He tries to show that the present fashionable idea that all sciences, including economics, must imitate the methods of physics, that they must be empirical, experimental, statistical, and quantitative, is not itself a scientific idea, but an arbitrary assumption. He rejects materialism, panphysicalism, and logical positivism, in fact, as “metaphysical” ideas that have perverted and set back rather than advanced economics and have led toward a philosophy of collectivism and totalitarianism. Economics, he contends, rests on an utterly different basis. Its subject is human action. In acting, men strive constantly to substitute a more satisfactory state of affairs for a less satisfactory state. In short, all men pursue ends, and resort to means in order to attain these ends.

I shall not attempt here to follow in detail Mises’s “epistemological” argument, but rather point to some of the practical conclusions to which it leads. One of these is his rejection of the tremendous emphasis placed in recent years on economic statistics and on “mathematical economics.”

## MATHEMATICAL MIRAGE

Hosts of authors, deluded by the idea that the sciences of human action must ape the technique of the natural sciences, are intent upon a “quantification” of economics. They assume that economics ought to imitate chemistry, which has progressed from a qualitative to a quantitative state. Their motto is the positivistic maxim: Science is measurement. But in the sphere of economics, i.e., of human action, Mises answers, there are no constant relations between any factors. Consequently, no measurement, no quantification is possible. The only measurable magnitudes that the sciences of human action encounter are quantities of the environment in which man lives and acts—acres of land, bushels of wheat, tons of coal. But these quantities tell us nothing about values, which depend upon human preferences, choices, means, and ends.

Statisticians get into insoluble dilemmas when they indulge, for example, in the modern sport of measuring “the national income.” “Income” itself is a somewhat arbitrary accountant’s concept, as the concept of “the *national* income” is an arbitrary political concept. Mises shows how this illusive concept depends on changes in the purchasing power of the monetary unit. The more inflation progresses, the higher the national income. Within an economic system in which there is no increase in the supply of money, progressive accumulation of capital and the improvement in technological methods of production to which it led would result in a progressive drop in prices. The amount of goods available for consumption would increase. The average standard of living would improve. But none of these changes would be made visible in the national income statistics.

## HOW CONSUMERS RULE

Some of the most interesting passages in Mises’ book deal with issues not directly connected with his central theme. In one of these he explains why private ownership of the means of production so effectively serves the public interest:

“The owner of producers’ goods is forced to employ them for the best possible satisfaction of the wants of the consumers. He forfeits his property if other people eclipse him by better serving the consumers. . . . Private property in the factors of production is a public mandate, as it were, which is withdrawn as soon as the consumers think that other people would employ it more efficiently. By the instrumentality of the profit-and-loss system, the owners are forced to deal with ‘their’ property as if it were other people’s property entrusted to them under the obligation to utilize it for the best possible satisfaction of the virtual beneficiaries, the

consumers. . . . It is precisely the necessity to make profits and to avoid losses that forces the ‘exploiters’ to satisfy the consumers to the best of their abilities.” ❁

## The Dream of Planning

September 24, 1962

The immense appeal to so many intellectuals and politicians today of the idea of government economic Planning rests on a simple but glaring oversight. The apostles of Planning forget that each of us, in his private capacity, is constantly planning ahead, regarding his job, his business, his leisure, his spending, his saving for a home or a car or the education of his children. And these millions of individual plans are coordinated through the marvelous mechanism of competition and the free market.

The question then is never whether there should be planning or not, but *who* should plan for whom? To put it another way, the question is whether each of us should be *free* to make his own plans, or whether all of us should be *forced* to work or consume according to some Master Plan drawn up for us by some supposed group of supermen. Most Plans being proposed today are plans for accelerating economic growth. But almost equally popular, under the influence of J.K. Galbraith, are Plans to control our spending and socialize consumption.

According to the Galbraith thesis, most consumers do not know how to spend the incomes they have earned. They buy whatever advertisers tell them to buy. They have atrocious taste, and crave cerise automobiles with ridiculous tailfins. They are, in brief, boobs and suckers, wasting their money on trivialities and junk.

### THE TWO ‘SECTORS’

The natural conclusion from all this is that consumers ought to be deprived of freedom of choice, and that government bureaucrats, full of wisdom—of course, of a very unconventional wisdom—should make their consumptive choices for them. The consumers should be supplied not with what they themselves want, but with what bureaucrats of exquisite taste and culture think is good for them. And the way to do this is to tax away from people all the income they have been foolish enough to earn over that required to meet their bare necessities, and turn it over to the bureaucrats to be spent in ways in which the latter think would really do people the most good.

The goods and services for which people voluntarily spend their own money make up, in the Galbraithian

vocabulary, the “private sector” of the economy, while the goods and services supplied to them by the government, out of the income seized from them in taxes, make up the “public sector.” This is a neat semantic triumph. For the word “private” is meant to suggest the selfish and exclusive, and the word “public” to suggest the democratic, the shared, and the public-spirited.

### VOLUNTARY VS. COERCED

But a truly descriptive vocabulary would throw a different light on the matter. For what Galbraith calls the “private sector” of the economy is, in fact, the *voluntary* sector; and what he calls the “public sector” is, in fact, the *coercive* sector. And as this sector grows at the expense of the voluntary sector we come to the essence of the welfare state. In this state nobody pays for the education of his own children, but everybody pays for the education of everybody else’s children. Nobody pays his own medical bills, but everybody pays everybody else’s medical bills. Nobody helps his own old parents, but everybody helps everybody else’s old parents. Nobody provides for the contingency of his own unemployment, his own sickness, his own old age, but everybody provides for the contingency of the unemployment, sickness, or old age of everybody else. The welfare state, as Bastiat put it with uncanny clairvoyance more than a century ago, is the great fiction by which everybody tries to live at the expense of everybody else.

This is not only a fiction; it is bound to be a failure. This is sure to be the outcome whenever effort is separated from reward. When people who earn more than the average have the “surplus,” or the greater part of it, seized from them in taxes, and when people who earn less than the average have the deficiency, or the greater part of it, turned over to them in handouts, the production of everybody must decline; for the energetic and able lose their incentive to produce more than the average, and the slothful and unskilled lose their incentive to improve their condition. ❁

## Planning for Growth

October 1, 1962

In a free economic system, production tends to be maximized. This is because, in such a system of private property and free markets, everybody’s reward tends to equal the value of his production. What he gets for his effort or his product, and is allowed to keep, is what it is worth in the market. In a free market, therefore, everyone has the incentive to maximize his satisfactions, whether these consist in more goods or in more leisure.

But along comes the Growth Planner. He finds by statistics (whose reliability he never questions) that the economy has been growing, say, “only” 2.8 percent a year. Whatever the rate is, he decides that it ought to be greater. How does he propose to increase it?

There is among the Growth Planners a profound mystical belief in the power of words. They declare that they “are not satisfied” with a growth rate of a mere 2.8 percent a year. They demand, say, an annual growth rate of 5 percent. And once they have spoken, they act as if half the job had already been done. If they did not assume this, it would be hard to explain the deep earnestness with which they argue among themselves whether the growth rate “ought” to be 4 or 5 or 6 percent.

### MAGIC TARGET RATE

But why do they assume that setting their magic target rate will increase the rate of production over the existing one? And how is their growth rate supposed to apply as far as the individual is concerned? Is the man who is already making \$50,000 a year to be coerced into making \$52,500 next year? Is the man making \$5,000 a year to be forbidden to make more than \$5,250 next year? If not, what is gained by making a specific “annual growth rate” a governmental “target”? Why not simply encourage everyone to do his best, or permit him to make his own decision, and let the *average* growth be whatever it turns out to be?

The way to get a maximum rate of “economic growth”—assuming this to be our aim—is to give maximum encouragement to production, employment, saving, and investment. And the way to do this is to maintain a free market and a sound currency. It is to encourage profits, which must in turn encourage both investment and employment. It is to refrain from oppressive taxation that siphons away the funds that would otherwise be available for investment. It is to allow free wage rates that encourage full employment.

### HOW TO SLOW DOWN

The way to *slow down* the rate of economic growth is of course precisely the opposite of all this. It is to discourage production, employment, saving, and investment by incessant interventions, controls, threats, and harassment. It is to frown upon profits, to declare them to be excessive, to file constant antitrust suits, to control prices by law or by threat, to levy confiscatory taxes that discourage new investment and siphon away the funds that make investment possible, to hold down interest rates artificially to the point where real saving and real investment are discouraged, to deprive employers of real freedom of bargaining, to grant excessive immunities and privileges to labor unions so that their demands are

chronically excessive and chronically threaten unemployment—and then to try to offset all this by increased government spending, deficits, and monetary inflation. But we have just described precisely the policies that most of the fanatical Growthmen advocate.

Their [recipe] for inducing growth always turns out to be—inflation. This does lead to the *illusion* of growth, which is measured in their statistics in monetary terms. What the Growthmen fail to realize is that the magic of inflation is always a short-run magic, and quickly played out. It can work temporarily and under special conditions—when it causes prices to rise faster than wages and so restores or expands profit margins. But this can happen only in the early stages of an inflation that is not expected to continue. The consequences of this short-lived paradise are malinvestment, waste, gambling, social discontent, disillusion, bankruptcy, increased governmental controls, and eventual collapse. This year’s euphoria becomes next year’s hang-over. Sound long-run growth is always retarded. ☸

## Worth the Price?

October 8, 1962

For the fiscal year 1963 the Space Director is asking for nearly \$4 billion for his agency alone. Before the race to the moon is finished, the program is expected to cost \$20 billion or more.

This is a huge sum. How will it be raised? By higher taxes? But taxes already take away from the corporations more than half of what they earn, and from individuals up to 91 percent of what they earn. As President Kennedy has already told us: “Our present tax system is a drag on economic recovery and economic growth. . . . Our tax rates, in short, are so high as to weaken the very essence of the progress of a free society—the incentive for additional return for additional effort.” Will the money be raised by deficit financing—i.e., by piling up our national debt still further, by printing more money? That way lies more inflation, further undermining confidence in the dollar.

Of course we must spend whatever is needed on national defense. And it is difficult to view the civilian space program entirely apart from missile and other military programs. Just as what was discovered in developing intercontinental missiles made the civilian space program possible, so the civilian program may in turn lead to discoveries of military application. Yet military advances are more likely to be achieved, and sooner and more cheaply, if they are aimed at directly.



## DIVERSION OF EFFORT

The space program may also lead to other incidental scientific discoveries and technical advances. It has already led to Telstar, with its immediately dramatic results and immense future possibilities. Scientists point to other potential benefits: Weather observation and prediction, more accurate navigation, improved mapping and miniaturization, new processes and materials.

Yet when all this has been said, the question remains whether these incidental or possible by-products will be enough to justify the huge spending, the huge diversion of national effort, that the space program involves.

Some basic questions are involved. Is it an appropriate function of government to engage in or finance scientific research? To what extent will government research programs supplement private research? To what extent are they likely, in the long run, merely to displace private research? And if the government is to take over the business of scientific research, how will it decide on the relative usefulness or urgency of a thousand different projects?

## MORE URGENT PROJECTS

It might be interesting and even exciting to land a man on the moon, but it would not be difficult to think of more necessary, urgent, or useful projects: Research to increase food production (notwithstanding our own insane farm program) to provide more and cheaper nourishment for the world's 3 billion population. Developing new and cheaper sources of power. Attacking a hundred human diseases, from cancer to the common cold, and prolonging human life. Finding cheaper and better ways to decontaminate air and water, or to turn salt water into fresh. Research on weather control, to mitigate floods and droughts, or to dissipate smog over cities. And scores of other projects that from the standpoint of increasing human happiness or reducing human misery seem to deserve priority over the Buck Rogers stunt of landing a man on the moon.

It is, indeed, not easy to find a satisfactory answer to the questions raised by former President Eisenhower: "Why the great hurry to get to the moon and the planets?" Are we merely engaged in "a mad effort to win a stunt race?" If we are in a race with Soviet Russia for world "prestige," should we let the Communists set the terms and the items?

Suppose, one day, after we have spent many billions in trying to land men on the moon, the Russians get there first?—a not improbable outcome, judging by experience to date. Then our billions of expenditures will acquire a negative value. Our prestige will be lower than if we had never entered the race. And meanwhile we will have diverted world attention (and our own)

from our immeasurable superiorities in the things that matter most—human freedom and dignity and standards of living. ☼

## Taxes and Growth

October 15, 1962

LONDON—There is no such thing as an ideal tax system, especially when the total burden is heavy. Every tax is a deterrent to production or consumption.

When we compare the British and American tax systems from this point of view, we find that the British system is better than ours in some respects, but even worse in others. It is much better, for example, in its treatment of corporations. We tax the net income of our own corporations 52 percent. (This comparison throughout is in broad outlines and ignores many qualifications on both sides.) The British tax the net profits of their corporations only 15 percent. In addition they levy an "income" tax on corporate profits of 7 shillings and 9 pence in the pound (38¾ percent), bringing the total to 53¾ percent. This seems equivalent to ours. But this full rate applies in effect only to undistributed profits. For when the corporation pays out dividends, the individual shareholders are credited with having already paid their "standard rate" (38¾ percent) of personal income tax on these dividends.

## DEPRECIATION

British companies also have an advantage over their American counterparts in depreciation allowances. The system is complex, but a typical example might work out like this: First, the corporation is allowed an "investment credit" equal to 20 percent of the cost of the investment. This is not deducted from its depreciation allowance. Then it is allowed an "initial" depreciation deduction of 10 percent. It may also take, say, a 10 percent depreciation at the end of the first year. In this way, it may write off 40 or 45 percent of a new investment in the first year.

All this is much more favorable than the depreciation treatment given to our own corporations, even under the new tax proposals. But British industrialists still complain that they are at a disadvantage with their competitors in the Common Market because of the much shorter period over which many of the latter may write off their investments entirely.

When we come to taxation on personal income, there seems to be only one major respect in which the British taxpayer enjoys an advantage over our own. This is in the treatment of capital gains. Until this year,



Britons paid no tax on these at all, unless capital gains were a regular part of business income. Now short-term capital gains (within six months for most property, three years for land) will be taxed as ordinary income. But long-term gains are still completely exempt from tax. And owner-occupied dwellings and other property are still exempt even from short-term capital-gains tax.

### HIGH RATE, LOW YIELD

In practically every other respect the British taxpayer seems much worse off than his American opposite number. Compared with our “normal” tax of 20 percent, the British “standard rate” (beginning at about \$1,000 of taxable income) is 38¾ percent. Our surtaxes, it is true, go as high as 91 percent, but stiff British surtaxes begin at much lower income levels and they reach a top rate of 88¾ percent for incomes above \$42,000. And the British death duties rise to 80 percent for those estates in excess of \$2.8 million.

The harm that such tax rates do to economic growth can hardly be calculated. Neither in the U.S. nor in Britain do they raise any revenue to speak of. In the U.S. the personal income tax rates over 50 percent raise less than \$1 billion—about 1 percent of the total Federal budget and enough to run the government for only three or four days. In Britain all the surtax rates together bring in only £188 million out of total revenues of £6,807,000, or less than 3 percent. All the death duties together bring in £265 million, or less than 4 percent. Yet in both countries such taxes gravely undermine incentives to production and saving. They siphon off the very funds most likely to go into investment. Both hurt wage-earners by retarding the rise in their productivity and real wages. Yet such destructive taxes are kept in the name of “social justice,” and both British and American government officials publicly wonder why the rate of economic growth in their respective countries is so disappointingly low. ❁

## Inflation—or Gold?

October 22, 1962

LONDON—The more closely we examine the world’s monetary chaos, the more obvious it becomes that the only solution is a return to a full gold standard. This means that currencies must be made unconditionally redeemable in a fixed quantity of gold, on demand, at home or abroad, by anybody, even a citizen of the country that issues the currency.

Some of the reasons why this is in the long run the only satisfactory monetary system were admirably

explained in a recent article in *Fortune* by Michael A. Heilperin. Other reasons have become clear in recent years. They were inadvertently emphasized by the proposals at the meeting of the International Monetary Fund in September. The history of the world’s currencies since the operation of the IMF began (i.e., since about 1947) has been a history of chronic inflation, followed by exchange controls, price controls, depreciation, devaluation, and repudiation. The most sweeping devaluations came in the fall of 1949, when the overnight slash of the British pound from \$4.03 to \$2.80 was followed in a few weeks by corresponding devaluations of 30 or more other currencies.

This process is not safely in the past. On the contrary, within the last twelve months or so, a dozen currencies have been partially or wholly devalued. These include not only those of such chronic offenders as Argentina, Brazil (five devaluations in the past twelve months), Chile, the Congo, Egypt, Israel, Indonesia, and South Korea, but Venezuela and Canada. There is no reason for supposing that this process has ended.

### THE IMF DEPLORES

It is true that the culprits have violated some of the paper rules of the fund. It is true that the IMF always piously deplores inflation, exchange control, and devaluation, and exhorts its member governments to monetary virtue. But the IMF system itself encourages domestic inflation and devaluation by removing or postponing the natural penalties. It is internal inflation that chiefly brings about a deficit in a country’s balance of payments. When that country does not have to meet its external liabilities in gold, when its foreign creditors can be told that it is an ungentlemanly thing to ask for gold and its citizens that it is a criminal thing to own gold, when it can demand credit or support from the IMF as a matter of right to tide it over the difficulties it has brought on itself, it can continue its inflationary policies longer and without sense of guilt.

And it is significant that whenever the IMF meets, the chief proposals by its national members are always for more domestic or world inflation. The British propose that the IMF print its own paper currency for individual central banks to use as “reserves.” The Americans want everybody to conspire to support the dollar, by swapping paper currencies and letting every nation count the others’ paper money as part of its reserves. This is officially called “increasing world liquidity.” A plainer term for it is increasing world inflation.

### HOW TO RETURN

Only a return to a full gold standard can bring this chronic inflation to a halt. Each inflating nation must be made to pay the penalty for its inflation immediately.

It must no longer be able to demand the automatic support of other nations through the IMF in helping it to continue its inflating.

The problems of how to return to a full gold standard, and at what gold value for the dollar and other currencies, are awkward ones. They are political and legal as well as economic. Heilperin suggests that a new gold price be fixed at \$70 an ounce and that the problem be solved internationally through a committee of the Organization for Economic Cooperation and Development. There is much to be said, however, in favor of the U.S. acting alone. If it does act internationally, then the IMF seems the appropriate instrument through which to do it. But once the world, or even the U.S. alone, recognizes the necessity of returning to gold, problems of method should not be insuperable.

One central relationship must be kept in mind. The world is unlikely to halt inflation until it returns to gold; and no nation can stay on gold unless it refrains from serious inflation. ❁

## Taxes in Sweden

October 29, 1962

STOCKHOLM—Some of our more knowledgeable businessmen and accountants, concerned by our government's niggardly rate of depreciation allowances in the past, have from time to time pointed out how much more liberal these allowances are in Sweden. They are. From 1939 until about four years ago a Swedish company could deduct the entire cost of a new machine in one year. Under present law it is still permitted to write off new machinery and equipment within five years.

In addition to this, a company may set up a deductible "investment reserve" of up to 40 percent of an entire year's profits. It must, however, deposit 46 percent of this reserve in cash in the Riksbank (the national bank) and, broadly speaking, can invest it only at times approved by the government.

Another substantial tax advantage enjoyed by the Swedish taxpayer is his relative exemption from long-term-capital-gain taxation. He pays straight income tax on 100 percent of capital gains on securities and other assets held for less than two years, but on only 75 percent of the gain on assets held between two and three years, on only 50 percent of the gain if the assets are held one year longer, on only 25 percent if held one year longer still, and no capital-gains tax at all if the asset is held more than five years. And he pays no capital-gains tax on real estate if he has held it more than ten years.

## HEAVY IMPACT

But this pretty much exhausts the relative tax advantages of the Swedish taxpayer. The corporate tax rate is roughly equivalent to our own. Corporate income taxes average about 49 percent, and shareholders must pay full income taxes, without deductions, on dividends received. Personal income taxes are extremely heavy. After exemption of only about \$400 for single persons and \$800 for a family, individuals first pay a local proportional income tax averaging about 15 percent. Then they pay, on the rest of their income, national taxes ranging from 10 to 65 percent. Thus the effective top rate not only can exceed 70 percent, but a family with a national taxable income of only \$1,200 could pay 23½ percent, while an individual with a taxable income of only \$4,000 would pay about 40 percent. The top rates above 70 percent apply to incomes above \$30,000.

And the tax impact is greater than these figures indicate. There is a general retail sales tax of 6 percent in addition to special excise and luxury taxes; a formidable annual capital levy on an individual's capital assets (regardless of whether he gets any income from them), and a severe inheritance tax.

## CAPITAL RESTRAINT

As in the U.S. and Britain, the higher rates give negligible yields. Ignoring the proportional local income tax rate averaging about 15 percent, and concerning ourselves exclusively with the national income tax, we find that the highest national rates—i.e., from 45 to 65 percent—yield about \$7 million, or only 1 percent of the total yield of national income tax. In fact, the Swedish Taxpayers' Association has figured, in a study shortly to be published, that 90 percent of the national income-tax revenues would be realized if the progressive rates stopped at the 25 percent bracket, and that just as much would be collected, without any progressivity of tax rates at all, by a flat national rate of 14 percent.

But though the yield from the high bracket rates is negligible (as is also the yield of the capital tax and inheritance tax) it is impossible to measure the restraining effect of such rates on the creation of income, on savings, and on the supply of venture capital.

Many Swedes tell you they are getting their extensive social-welfare services "free"—education, unemployment insurance, old-age pensions, medical care. But the Taxpayers' Association study makes it doubtful that there is even much redistribution of income or welfare from the "rich" to the "poor." Half of the population now pay 30 to 40 percent of their income in taxes. Two-thirds of the tax money levied for redistribution purposes in effect returns as "social services" to the

identical income groups that paid it, after an enormous merry-go-round. ❁

## Will Europe Split?

November 5, 1962

BERN—Because of our own unique position, few Americans realize the impact of the Common Market on its Western European neighbors. Our own merchandise exports amount annually to only 4 percent of our gross national product, and those to the Common Market countries to only about 1 percent.

Contrast this with the position of some neighboring European countries. Switzerland is already so integrated economically with the rest of Europe that its very survival depends on continuance of this relationship. Its exports amount to 25 percent of its gross national product. In some industries—watches, chemicals, dye-stuffs—its exports constitute 90 to 95 percent of total output. The proportion of Swiss trade with Europe reaches about 80 percent for its imports and more than 60 percent for its exports. Last year 62 percent of its imports came from the six Common Market countries and 42 percent of its exports went to them. Switzerland, in short, is already more integrated with the Common Market countries than those countries are with each other.

The relation of Sweden to the rest of Europe is almost as striking. More than 25 percent of Sweden's national product is exported. Imports are equally high. Both in exports and imports some two-thirds of Swedish foreign trade takes place with the other EEC and EFTA members. Present members of the EEC account for a third of Swedish trade.

### DANGERS OF EXCLUSION

Both Switzerland and Sweden are following the negotiations between Britain and the Common Market with intense interest. The outcome will affect the terms of their own association, if any. Exclusion from the Common Market could profoundly disrupt their economic life. They have applied for "associate membership." By this they mean that they are willing to accept in full all the economic obligations implied by membership without the purely political obligations. Switzerland, for example, neutral by long tradition, would like to retain the right to negotiate trade agreements with third countries, or to withdraw in case of war. But our own government, which has taken so active a part in promoting the Common Market, and in urging British membership, is actively discouraging even associate membership by Switzerland, Sweden, or Austria.

I have talked about this problem with a score of the leading bankers, industrialists, labor leaders, and government officials of Sweden and Switzerland, including Switzerland's Foreign Minister and former President, F.T. Wahlen, Sweden's Minister of Trade, Gunnar Lange, and its Prime Minister, Tage Erlander. While government officials are careful to refrain from any criticism of the American attitude, it is obvious that they as well as more outspoken private citizens are deeply disturbed by it.

### BUGBEAR OF 'DILUTION'

Our government's objection even to associate membership for Austria, Switzerland, or Sweden is based on a vague fear that this would "dilute" the Common Market. On the economic side, the three countries find this baffling because our government wants to dilute the Common Market by urging the adherence of the British and accepting that of the Norwegians, Danes, and Greeks. As the Swiss, Swedes, and Austrians do not even wish to participate in the *political* decisions or institutions of the Six, they cannot understand how their purely economic association could in any way reduce the will of the Six to achieve closer political ties with each other.

As the European neutrals see it, the United States can only hurt its own political and economic interests by weakening the ties that already bind these neutrals into the European economy. To keep them out of the Common Market would not only do them immeasurable economic harm, but would tend to drive them for self-preservation toward greater ties with Iron Curtain countries. Many Europeans point to the tremendous Russian pressure now being put on Finland, and the possibility that our government's indifference may force Finland into the Russian orbit. Our policy, as they see it, may tend not to unite Western Europe, but to split it into two rival camps, weakening or destroying the ties that already exist. ❁

## Shock of Reality

November 12, 1962

People who write on the future of American business ordinarily do so on the tacit assumption that the forces determining the future of business lie within the realm of business itself. Along comes a Cuban crisis, and suddenly everyone realizes that the future of American business is simply a part of the future of America. What happens to business depends as much on our "foreign" policy as on our "economic" policy.



I trust I shall not be thought to roam too far out of the purview of this department, therefore, if I express the hope that the outcome of the Cuban crisis may lead us to abandon some of the unrealistic assumptions on which that foreign policy has rested for the last eighteen years.

It is clear in retrospect that, prior to the present agreement on Cuba, the Kennedy Administration made some very costly errors. These were not merely the errors in the few weeks preceding the Oct. 22 announcement of the blockade—the denials, for example, of Republican charges that offensive missile bases were being constructed in Cuba. The errors go back at least to April 12, 1961, when (after his own State Department, nine days before, had correctly described developments in Cuba as “the seizure by international Communism of a base and bridgehead in the Americas”) President Kennedy declared that “there will not *under any conditions* be an intervention in Cuba by United States armed forces.” This was followed five days later by the disastrous failure, through the Administration’s vacillation and timidity, of the invasion of the Bay of Pigs. This blow to American prestige was followed by eighteen months of tragic inaction while the Soviet buildup went on.

#### RECORD OF APPEASEMENT

But we can now hope that the apparent victory resulting from our finally firm stand on Cuba may signal a reversal of the yielding and appeasement that have plagued our foreign policy under both Democratic and Republican leadership for the last eighteen years. President Truman must accept responsibility for acceding to an untenable position for the West at Berlin, and for his prior ambiguity about our willingness to defend South Korea. And President Eisenhower must accept responsibility for not only failing to provide any real aid, physical or moral, to the Hungarian Freedom Fighters in 1956, but for actually diverting world attention from that Communist crime by taking that moment to halt France, Britain, and Israel in an action that, without his intervention, would have deposed Nasser and prevented the immense harm he has since done. It was the Eisenhower Administration, also, that rushed to recognize Castro and failed to break off relations with him until its last weeks in office.

#### FRUITS OF FIRMNESS

The truce resulting from President Kennedy’s bold action once more confirms the ancient truth that honorable or tolerable peace is not to be bought by a timorous appeasement but by firmness. As the Swiss economist Wilhelm Röpke put it eight years ago: “Pacifism, merely as an attitude of mind that rejects war, is not only sterile but indeed dangerous to a tragic degree, since at

the very moment when the danger of war is greatest it further increases that danger immeasurably by encouraging the attacker. Such pacifism not only fails but actually becomes one of the fatal links in the chain of causes which trigger off the war and possibly effect the triumph of the aggressor. The chief task of war prevention is to make plain to every potential aggressor, beforehand and in a completely indubitable way, that the risk is overwhelming.”

The outcome in Cuba does not mean, of course, that the dangers of the cold war are past. No one knows what Khrushchev’s next moves will be in Berlin, or what the consequences will be if Cuba is allowed to remain as a Communist “base and bridgehead in the Americas.” But we have now learned that, in the moment of crisis, time does not allow us to consult a score of other nations, and that we must decide and act swiftly and alone, trusting in our own strength and the readiness of other countries to follow a firm, clear lead.

And what’s best for America is best for American business. ☸

## ‘Tax’ Cut vs. Rate Cut

November 19, 1962

Last summer Mr. Kennedy let it be known that he favored a tax cut of “at least \$7 billion a year.” “Our present tax system,” he declared on Aug. 13, “is a drag on economic recovery and economic growth. . . . Our tax rates . . . are so high as to weaken the very essence of the progress of a free society—the incentive for additional return for additional effort.”

Everybody agrees that present taxes are too high. But a cut of the dimensions indicated, without a corresponding cut in spending, would touch off a new spiral of inflation and endanger the dollar. We have already had 26 deficits in the past 32 years. The Council of State Chambers of Commerce, before the Cuban crisis, estimated that the deficit in the current fiscal year would reach \$7.7 billion. A tax cut of \$7 billion could mean an annual deficit of \$15 billion. Yet in despair of the political prospect for any cut in spending, groups and institutions ordinarily deeply concerned about inflation now advocate a tax cut even without a spending cut.

The latest example is the First National City Bank of New York. After an instructive comparison of the American tax system with that of other nations, its November letter concludes: “Our present tax system is bankrupt. It deters effort and progress. It has not succeeded in balancing the budget. We desperately need



an imaginative new fiscal combination, even at the initial cost of some continuance of deficits. Easier taxes on enterprise could invigorate the economy [and] build a bigger base of taxable income."

### 1 PERCENT OF REVENUES

May it not be possible, however, to reform our tax system without plunging into still bigger deficits in the hope that lower taxes will themselves restore a balanced budget in some sweet by-and-by? We need merely recognize that the greatest harm is being done by the excessive tax rates on the higher personal incomes. All U.S. personal income-tax rates above 50 percent yield less than \$1 billion, i.e., less than 1 percent of total Federal revenues. The experience of other countries also shows that such punitive rates produce negligible yields. Yet such confiscatory rates immensely discourage effort, siphon off most of the very funds otherwise available for risk capital, and undermine the incentive to invest what is left.

If we stopped our income-tax progression at the 50 percent rate there can hardly be any doubt that this would result in an actual *increase* in governmental revenues. It would certainly result in an increase of economic growth from increased effort, increased capital accumulation, increased investment, increased job opportunities, and higher real wages.

### DO HIGH RATES PAY?

The City Bank comparisons show that our top rate at 91 percent is the highest of any important country in the world. As the bank points out:

"It is sometimes thought that high rates and heavy reliance on income taxation necessarily go together. Such is not the case. The bulk of the revenue from the tremendously productive Federal individual income tax is derived from the initial 20 percent rate. In 1960, 86 percent of receipts came from this first bracket rate, to which all taxpayers are subject, while the entire progressive portion up to 91 percent produced only 14 percent of the yield. Collections were 23.3 percent of the total taxable income reported in 1960, which implies that a flat tax of 23.3 percent would produce the same revenue as the present steeply graduated schedule."

To raise the individual exemption by even \$100 would cost some \$3 billion in revenues. But to lower the 20 percent rate to 19 percent on the first \$1,000 of taxable income, or alternatively, to continue the 20 percent rate (which now applies only to taxable incomes of \$2,000 or less for single persons) through the \$2,000 to \$4,000 bracket (which now pays 22 percent) would mean a revenue loss of only about \$750 million.

With such changes at the top and bottom of the rate scale, the complexity of the income-tax schedule

would be enormously reduced—from 24 tax rate brackets to eight or nine. This could be a cautious start toward further tax reduction spread over the following years. ☼

## Tax Cuts for Incentive

November 26, 1962

This year, at the initiative of the Kennedy Administration, two important steps were taken to increase the incentives for new investment. One was the tax credit of 7 percent of the cost of new equipment. The other was the Treasury's new rulings permitting business to depreciate equipment over shorter periods.

The Treasury estimates that in a full year the tax credit will cost it \$1 billion in revenues, and that the new depreciation rulings will cost it another annual loss of about \$1.5 billion. If this were so, business could keep \$2.5 billion more a year (about 5 percent) of present profits and the added amount would be available for new investment.

But such estimates are likely to apply only in the early years of the new reforms. As business cannot in the long run write off more than 100 percent of the cost of equipment, the government must stand to make up any early revenue loss in later years. Broadly speaking, in fact, all that changes in depreciation allowances do (unless, as in France, they allow also for depreciation of the currency) is to shift the amount of reported earnings, and hence the amount of taxes, as between one year and another. Accelerated depreciation allowances reduce reported profits, and hence taxes, in earlier years at the cost of increasing profits and taxes in later years.

### TO STIMULATE GROWTH

Yet because the long-term return on investment in new equipment is always problematical, particularly over more remote years (the rate of obsolescence, or shifts in demand, can never be known in advance), because the principal of the investment is more surely and quickly recouped, and because the net outlay in the early years is less, shorter depreciation periods increase the incentive for new investment. This means two things. As a result of accelerated depreciation the government in the long run *increases* revenue rather than loses it. More importantly, corporations invest more, scrap obsolescent equipment sooner, expand and modernize, meet foreign competition better, provide higher-paid jobs. In brief, the economy expands faster and so does the tax base.

The Machinery and Allied Products Institute has just published a study of the probable stimulating effects of the new investment credit and the changes in depreciation rules. It estimates that the tax credit is equivalent to an initial depreciation write-off of about 25 percent, and that the credit and shortened depreciation life are together equivalent to an initial write-off of 33 percent.

#### INITIAL WRITE-OFF

The stimulating effect of the changes on new investment may be substantial. This is the kind of “tax reduction” most likely to appeal to conservative members of Congress. It promises to reduce the depressing effect of taxes without in the long run reducing revenues. It might be even better if, instead of the complications of the new investment credit and “guideline class” depreciation rules, we simply followed the example of Sweden and allowed corporations to write off new machinery and equipment within five years, or (as in Britain) to write off 40 percent of a new investment in the first year, or to choose one of several such options. We might be astonished at the effect on our economic growth.

It is reassuring to learn that the Administration’s tax planners are considering the possibility of spreading its proposed tax reduction over five years, to prevent a massive budget deficit in a single year that could set off inflation fears. In such a program an initial moderate change in the corporation income tax will probably be considered. One such change might be to keep the present rate of 52 percent on undistributed profits, but to reduce the rate to 48 percent on all profits paid out in dividends. As corporations in recent years have been paying in dividends about 30 percent of their profits before taxes, this would be equivalent to an average overall corporate rate of 50.8 percent. Even if this were made a substitute for the present 4 percent tax credit allowed to individuals on dividends received, it would mitigate the double tax on dividends in a way less open to misunderstanding. ❁

## What Is a ‘Loophole’?

December 3, 1962

The Administration seems to be divided on whether it should recommend simply a tax “cut” in 1963 or whether it should also demand tax “reform.” Unfortunately it seems to have precisely the wrong idea of what constitutes true tax reform. True tax reform would make our tax system simpler, less vexatious, less inequitable, less

discouraging to business growth. The “reforms” insisted on by the Administration at the last session of Congress were mainly in the opposite direction. It tried unsuccessfully to get interest and dividend withholding that would have created an accounting nightmare. It succeeded in getting punitive taxes on foreign investment, and stringent rulings on business expenses.

Here is *The Wall Street Journal’s* summary of the proposed application by the Internal Revenue Service of the new expense-account law:

“Anyone claiming deductions of \$10 or more for travel would have to provide documentation of the cost of transportation, meals, lodgings, telephone expense; date and hour of departure and return; number of days away from home; number of days spent on business at each stop; location of each stop, and the business purpose of the trip, ‘including the nature of the business benefit expected to be derived by the taxpayer as a result of the travel to each place.’”

#### KILLING INCENTIVE

The requirements for entertainment deductions are even more inquisitorial. They would constitute what the Journal calls “a bookkeeping nightmare,” and a “blow to travel and entertainment and indeed all business.” In order to catch a few cheaters, must every taxpayer or businessman be treated as a potential crook?

In its November Survey, the Morgan Guaranty Trust Co. of New York describes the multitudinous ways in which the high corporate and individual income tax rates have distorted business practice, and twisted incentive into strange shapes where they haven’t killed it altogether. Many savings in corporate costs hardly seem worth the effort when it is pointed out that they really amount only to 48 cents on the dollar. “Beyond the dollars and cents,” concludes the bank, “enormous harm has been done to business by the colorful mythology that has grown up around practices designed to help the individual avoid losing the greater part of his pay to taxes. Externally, the exaggerated impression of rampant abuse has damaged public respect for, and confidence in, business. Internally, it has chipped away here and there at business morale and business ethics.”

#### CONFISCATORY RATES

The favorite demand of most tax “reformers” is that we must “close the loopholes.” But what is a loophole? Those who invoke the catchword never refer to the exemptions and deductions that apply to the low-bracket incomes. They use it only to stigmatize the deductions that those who earn high incomes are permitted to take, implicitly or explicitly, by the law. They do not stop to ask whether a deduction is fair or unfair. Do a few abuse it? Then it should be denied to everybody. Even President

Kennedy, in his tax message to Congress on April 20, 1961, said: "The slogan—'it's deductible'—should pass from the scene." He was talking of expense-account abuses; but if his statement were taken without qualification, no expense deduction, no matter how legitimate, would ever be allowed. Even a company that lost money would pay taxes on its gross. It is only because of expense deductions and "loopholes" that most businessmen are able to stay in business at all.

The kind of tax reform we most sorely need is not that proposed by the "loophole" closers. The most important tax reform is to stop confiscation. Any tax rate above 50 percent, on corporate or individual income, is *prima facie* confiscatory. We need to reduce the multitude of income brackets, to stop penalizing irregular incomes, to deal in a more balanced way with capital gains and losses. If we undertook this kind of reform we could at the same time *reduce* tax rates and *increase* revenues. More importantly, we would enormously stimulate income, production, employment, and national economic growth. ❁

## No Column This Week

December 10, 1962

In a world drifting toward economic chaos, the weekly problem of choosing a topic, to the neglect of all other topics, sometimes becomes insoluble. Take this week, for instance.

With the Administration talking of a tax cut of \$5 billion to \$10 billion in 1963, though the outlook for the current fiscal year is already for a deficit of \$8 billion without a tax cut, I get to ruminating about the gross and glaring inequities in our income tax. When Treasury officials have been questioned about these in the past, their excuse for retaining them has been, "We need the money." Now they say they don't want at least \$5 billion of it. But nobody suggests that this might be a good time to end some of these inequities.

Take, for example, the gross unfairness to people with irregular incomes. An official of a small bank with a steady net taxable income of \$10,000 a year pays over ten years, on his \$100,000, a total income tax of \$26,400. But a writer, inventor, or actor, who had no taxable income for nine years but \$100,000 such income in the last year, may be forced to pay an income tax on it of \$67,320. Yet nearly everyone would prefer a steady and predictable income to an irregular one of the same amount. Then there is the cynical heads-I-win-tails-you-lose policy in taxing capital gains and losses.

But I've been writing too much about taxes lately, so I'll skip that.

### INFLATION IN BRAZIL

Then I think of the rampant inflation in Brazil. Prices there have risen more than 50 percent in the last twelve months. Even last August the cost of living had already increased to ten times that of 1953. It now takes more than 700 cruzeiros to buy a dollar. People are rushing to change their money for anything. Brazil got into this inflation by the most approved New Frontier method—budget deficits. The budget deficits were also brought about by the methods most approved by our own progressive thinkers—losses on socialized enterprises. The government has also ordered a year-end bonus equivalent to one month's pay for all Brazil's salaried workers, and a new and higher legal minimum wage to go into effect in January.

One wonders whether the Brazilian example will cause our tax-cut-happy, big-spending, deficits-for-"growth" theorists to have any second thoughts. One wonders whether the inflation, socialization, and confiscation throughout most of Latin America are causing any second thoughts to the daydreamers about the Alliance for Progress. One wonders whether the Brazilian inflation will even cause anybody to ask whether the International Monetary Fund, under which inflations and devaluations have been occurring with unparalleled frequency, serves any useful purpose at all.

### CAPITALISM IN RUSSIA

But then I think of the Russian situation. The U.S.S.R. idolators here have been telling us for years that Russia is growing faster than the U.S. and will soon leave us far behind in the race for production unless we too adopt socialist planning. The only people who begin to have doubts are the Russians themselves. Things are going so badly in Russia, particularly in agriculture, that Khrushchev has decided in desperation to imitate capitalism. Why shouldn't we "use anything rational and economically advantageous that the capitalists have to offer," he asks defiantly. So he announces one of the most sweeping reorganizations of the Soviet economy on record. He wants plants and industries to try to maximize profits. He proposes to tie managerial compensation closely to these. Communist radicals even recommend the introduction of a rate of interest on invested capital in Russia, in flat disregard of the Marxist dogma that interest, like profit, is simply exploitation of the workers. I might write a piece on the theme that while the Western radicals want to rush us toward Communism, the Russian radicals are moving



toward capitalism, and in a few years East and West may pass each other going in opposite directions.

But as I can't make up my mind which of these subjects to take up this week, I won't do a column on any. There's too much to write about. ❁

## The New Mythology

December 17, 1962

The belief that inflation can solve all the economic problems of mankind has the immortality of the phoenix. Discredited a hundred times by its ultimately tragic consequences, it always rises again in a new form. Its present form is the conviction that whenever the economy needs a lift, the sure way to get it is by a big enough budget deficit.

In a report on Nov. 19, a majority of the President's Advisory Committee on Labor-Management Policy called for a tax cut in 1963 of \$10 billion. A few thought maybe a tax cut of \$5 billion would be big enough. Some members urged that, in addition to cutting taxes, the government ought to increase spending. Nobody on the committee suggested that the government should actually reduce spending. The report never troubled to mention the \$7.8 billion deficit already officially estimated.

The committee had no doubt that a thumping deficit was the way to "achieve and maintain fuller utilization of manpower, higher industrial operating rates, and a more rapid rate of economic growth."

Just how deeply embedded the faith in deficits has become was illustrated by an article in *The New York Times* of Nov. 18: "Economically, there is no longer any essential disagreement among theorists over the fact [!] that deficit spending is a stimulus. . . . If the economy is not generating enough demand to keep it going at close to full tilt then the government must generate the demand, by deficit spending if necessary. . . . This view . . . is central to economic thought and theory in today's world."

### PRINTING MORE MONEY

It is precisely because this has become the new orthodoxy—which one can challenge only at the cost of being dismissed as hopelessly out-of-date—that the government seems likely to launch on a policy that can only end in monetary collapse.

Let us analyze this theory a little. It assumes that all unemployment or business slack must be the result of "insufficient demand." But by insufficient "demand" it always means insufficient *money*. The supporters of the theory want deficits because they want the government

to shovel more money into the economy than it takes back in taxes in order that everybody will have more money to buy more things. In brief, they want more inflation.

The theory assumes that bigger deficits, more money, more inflation, will inevitably "lift the economy." But they can do so only for brief periods and under special conditions. If union pressure forces some wage rates too high in relation to prices, then an added injection of money into the economy may increase either sales or prices, thus restoring sales or profit margins and enabling industry to pay the higher wage rates.

### WAGE RATES IGNORED

But this result will follow only if: (1) It does not lead to still further wage demands, or (2) if the price rises are at least greater than the wage rate rises, and (3) if the added dose of money is expected to be the last one, and not merely the beginning of an indefinite number of doses. In the latter case the inflation will get out of control.

The deficit-idolaters always ignore wage rates, and their effect on employment. Under no conditions, apparently, do they think any wage rate should be adjusted downward to coordinate wages, prices, and profits and restore employment. Always the whole level of prices must be raised instead.

But unless distortions are removed from the economy, unless there is freedom, flexibility, and coordination of wages and prices, even the greatest dose of deficit financing cannot restore full employment. All it can do is to intensify our problems. Our costs are getting too high for competition in the world market. More deficits can only make them higher. The deficit in our balance of payments, the outflow of gold, the dwindling confidence in the dollar, are all the result of the inflation we have already had (from 27 deficits in the last 33 years). The prospect of still more inflation can only lead to a renewed outflow of gold, or a devaluation of the dollar and a profound shock to world confidence. ❁

## Encouraging Strikes

December 24, 1962

The strike of the printers' union against New York newspapers raises once more the vexed question of what the attitude of government and the law should be in regard to unions and strikes in general.

A word ought first to be said about the merits of this particular strike. In October the average weekly wage paid in all U.S. manufacturing establishments was \$97.



(This compares with an average of \$68 in 1952, of \$37 in 1942, and of \$17 in 1932.) The New York newspaper printers were getting \$141 a week. They initially asked for \$160, and for a basic 30-hour week. The publishers offered an increase of \$8 a week over two years, to correspond with the settlement of the Newspaper Guild strike. The Typographical Union replied that the publishers had not even begun to “negotiate.”

The plight of the New York printers hardly seemed desperate enough to justify their action in calling a strike at the height of the Christmas season, throwing 20,000 people directly out of work, injuring thousands of small newspaper stands and stationery stores, and depriving more than 5 million people of their daily papers. If the strike goes on long enough, or is settled on burdensome terms, it may put some newspapers permanently out of business and their employees out of work.

### CAN UNIONS RAISE WAGES?

Why does the public tolerate such strikes against it, year in, year out? Probably because most people still believe that the unions, using the “weapon” of the strike, can in fact raise wages above the level they would otherwise reach. Economic analysis has shown again and again that this belief is a delusion.

The unions can raise *money* wages. But the gain is canceled out (with the help of inflation) by an equivalent rise in prices. Or an individual union can force an increase in wages for its members *at the expense of all other workers*, who must pay that wage increase in higher prices. In recent years the most highly paid workers have been achieving further victories against the more poorly paid. But union pressure cannot raise *real* wages for *all* workers. The attempt only creates unemployment. Our persistent 5.8 percent unemployment, in spite of record GNP figures, is mainly the result of excessive wage rates in key industries.

But the delusion that strikes and union pressure can raise real wages for all workers above the level that free competition would have brought is the reason why the law encourages unions and strikes.

### LAW NOT IMPARTIAL

Under the Taft-Hartley Act the government has become, in effect, a union-organizing agency. It legally *compels* an employer to “bargain” with a specified union. It confers on a union representing a mere majority, *exclusive* power to bargain for *all* the workers in a given unit. It in effect grants unions the intimidating and coercive powers of mass picketing. It in effect deprives the employer of the right to treat a striker as a man who has quit his job, and to replace him peaceably and permanently. This is why a steel plant or newspaper no longer even

attempts to carry on its business during a strike. In New York even strikers, after nine weeks, are entitled to unemployment insurance.

Yet the strange myth continues that the government and the law are “neutral” during a strike. When a strike occurs, instead of there being any demand for revision of the laws that encourage the strike (and reduce its risks) there are demands for still more government intervention—direct intervention of the President or Secretary of Labor, resort to the compulsory return-to-work period of the Taft-Hartley Act, compulsory arbitration, even direct wage and price fixing.

But no one calls for the obvious solution—to revise or repeal all the Federal labor legislation since 1931 and return to the principles of the common law. Under these principles unions would no longer be privileged to resort to intimidation or coercion. Individual workers would be free to join or not to join unions, to strike or to stay on the job.

Wages, employment, production, peace, would all gain by the change. ⚙

## Deficits Solve Nothing

December 31, 1962

President Kennedy’s speech before the Economic Club of New York was a mixture of the sound and the unsound. He said many good things and sometimes said them admirably. He warned that our balance-of-payments problem places limits on monetary inflation. He warned against the demoralizing effects of “increasing Federal expenditures more rapidly than necessary.” He recognized the need to reduce “the burden on private income and the deterrents to private initiative.” He pointed out how our present tax system constitutes “a drag on growth” because it “siphons out of the private economy too large a share of personal and business purchasing power” and reduces the “incentives for personal effort, investment, and risk-taking.”

The Federal government’s most useful role, Mr. Kennedy recognized, “is not to rush into a program of excessive increases in public expenditures, but to expand the incentives and opportunities for private expenditures.” He insisted that “corporate tax rates must also be cut to increase incentives and the availability of investment capital.”

The President also stated admirably the need for tax reform and some of the objectives of such reform. He pointed out how our present tax system distorts economic judgments and inhibits economic growth. He courageously urged reduction of “the oppressively

high rates in the upper brackets.” He emphasized the need of improving profit margins and increasing “the incentive to invest and the supply of internal funds for investment”; of arousing a “new interest in taking risks, in increasing productivity, in creating new jobs and . . . long-term economic growth.”

### **CUT SPENDING FIRST**

But in spite of these correct perceptions, the President did not draw the correct conclusions for practical action, because he looked at only one side of the problem. We do need tax reform. We do need tax reduction. But we cannot afford to reduce taxes unless we are also willing to reduce the Federal spending that makes the taxes necessary. Yet the President holds out no prospect whatever that Federal spending will be reduced. On the contrary, “defense and space expenditures will necessarily rise.” The most the President promises is that “the total of all other expenditures combined will be held approximately at its current level.”

What does this mean? In the current fiscal year we are heading into a deficit already officially estimated at nearly \$8 billion. This will be the 27th deficit in the last 33 years. The President’s advisers have been publicly recommending a tax cut in the neighborhood of \$10 billion. This could mean a deficit in the next fiscal year of \$18 billion. Add a couple of billion to expenditures, and you get a deficit around \$20 billion.

### **A TEN-YEAR TRIAL**

The President and his advisers seem to believe that deficits themselves, by increasing “purchasing power,” will increase prosperity, eliminate unused capacity, bring full employment, and thereby increase revenues and so restore a balanced budget. This beguiling fantasy has been floating around for 30 years. It is part of the reason why we have already had 27 deficits in 33 years. It is a complete delusion.

Deficit spending as an economic panacea has had a thorough trial. It got an uninterrupted test in the ten fiscal years from 1931 to 1940, inclusive, in which there was a deficit every year. The average annual deficit was \$2.8 billion, or 3.6 percent of the gross national product of the period. The same percentage of the gross national product today would mean an average annual deficit of \$19.7 billion. The average unemployment in that ten-year period was 9.9 million. This was 18.6 percent of the total labor force. The same percentage of unemployment today would mean 13.9 million jobless.

But though deficits brought about by cutting taxes would probably be futile in restoring full employment, they would not be harmless. On the contrary, they would undermine domestic and foreign confidence in the dollar. They would lead foreigners to drain us of our gold supply. And they would eventually let loose an uncontrollable inflation. ☸



1963





## Who Gains by Strikes?

January 7, 1963

It is easy to point to those who do *not* gain by a strike. Let us look at the present newspaper strike in New York City.

1—*Not* the employers. Their losses are direct and heavy; some papers may not be able to sustain them. If they are forced to settle on the strikers' terms, or even on terms higher than they offered to avoid the strike, they will be saddled with higher labor costs. If they try to compensate by raising the price of their papers or of their advertising, they will sell less of both. When, like the steel companies, employers are in foreign competition, they will lose business to their foreign competitors.

2—*Not* the public. The New York public loses by being deprived of the full daily information that only newspapers can supply. Department stores lose. Specialty stores lose. The owners of small newsstands and stationery stores lose. From every strike the public suffers at least inconvenience and sometimes serious hardship. It is deprived, while the strike lasts, of the particular product or service that the strikers helped to supply. And if the strike is settled by an excessive increase in wages, the public must pay a higher price for that product or service.

3—*Not* the whole body of workers. They constitute the overwhelming majority of consumers. They suffer the same inconvenience or hardship as the rest of the public during a strike. They also must pay higher prices afterward for the product or service supplied by the former strikers. This reduces the purchasing power of their wages. Workers in other industries often lose their jobs as a result of a strike. If some of them receive less pay at their jobs than the strikers did at theirs, they are not allowed to apply for the jobs that the strikers have voluntarily vacated. The "solidarity" in the interests of "all labor" is a myth. The wage gains of one group of workers as a result of a strike are nearly always at the expense of other workers through the higher prices that the others must pay.

4—Do even the strikers themselves gain from a strike? The truth is that they can do so only under very special and unusual conditions. Even when they "win" a strike they may lose—especially if the strike is prolonged, or if they win excessive gains. What labor is mainly suffering from today is too many victories.

In the New York newspaper strike, the printers were receiving a basic wage of \$141 a week. The publishers offered an increase to \$149 a week over a two-year period. The printers asked an increase to \$160.

## WHAT STRIKERS LOSE

For the first year the publishers offered an increase of \$4.25 a week. The printers asked an increase of \$10, or \$5.75 more. By striking they lose \$145.25 a week. Even if they win their full \$10 demand, therefore, it will take them 25 weeks, or almost half a year of work, to make up for *every week* lost on strike. Even if they were to win their whole fantastic "package" demands, now estimated at an increase of \$38 a week, they could win them only by throwing several newspapers out of business and thousands of employees out of work.

Anyone who thinks this prediction overdrawn should look at the record of the 1959 steel strike. This ran for 116 days, with an average wage loss of \$2,100 per worker. If we compare the workers' wage increase with what they would have got if they had accepted the steel companies' last offer before the strike, we find that in the three years since the settlement they have made up less than half the losses they suffered. That is, those who have remained employed have done so. But as a result of the increased labor costs imposed on the steel companies, fewer have remained employed. Total nonagricultural employment in September 1962 was 63.1 million in 1958, an increase of 8.6 percent. But employment in steel mills *dropped* from 601,100 in 1958 to 565,900 in September 1962, a fall of 5.8 percent.

We may yet have to revise our labor laws, ceasing to force employers to bargain only with a specified union, and ceasing to permit intimidatory picket lines, if only to prevent shortsighted unions from committing economic suicide. ☸

## A Shortsighted Tax

January 14, 1963

Any tax cut that led to still another budget deficit—which means any tax cut not accompanied by an equal or more than equal cut in expenditures—would be a cruel deception of the American people. It could precipitate an inflation that would do immense harm. But this objection does not apply to proper tax *reform*. Our present system embodies rates and types of taxation that are not only inequitable, but actually reduce possible revenues at the same time as they retard economic growth.

An outstanding example is the capital-gains tax. This tax is cynically one-sided. It is a heads-I-win-tails-you-lose proposition of the government against the taxpayer. Short-term capital gains are taxed in full, to any amount, just as if they were added income. But capital losses can be deducted only against gains, if any, and

not against income, except to a maximum of \$1,000 in any one year. Long-term capital gains (i.e., gains from assets held longer than six months) are treated similarly as compared with losses, though such capital gains are taxed at a maximum rate of 25 percent.

### GAINS VS. LOSSES

Prior to the market collapse and depression of 1929–33, capital gains were taxed as income, and at the same rates. And capital losses were fully deductible against income. But when J.P. Morgan revealed that he had paid no income tax for the preceding year, because his capital losses exceeded his ordinary income, his statement made front-page headlines. Then Congress one-sidedly “rectified” matters by refusing to allow deduction of more than \$1,000 a year of capital losses against income, though it continued to tax short-term capital gains in full as income.

Another gross injustice of the present capital-gains tax is that the “gains” it taxes are often nonexistent. Suppose a man bought stock or real estate for \$10,000 in 1939 and sold it for \$21,800 in 1962. He would be taxed on a long-term capital gain of \$11,800. Actually, as the cost of living also rose 118 percent in that period, he would have achieved no capital gain at all. His \$21,800 in 1962 could buy no more than \$10,000 bought in 1939. If he had sold his real estate or stock for \$19,000, he would be taxed on a capital gain of \$9,000, but he would have suffered an actual loss in real terms. Under past and prospective inflation, the long-term capital gains tax amounts to a large extent to nothing else but capital confiscation and expropriation.

Its evils do not end there. By taxing gains in full, and short-term gains at sometimes confiscatory rates, with loss deductions only against gains (except for a token deduction against income), it discourages all investment, and particularly of risk capital. It “locks in” capital. It penalizes investors heavily for transferring investments into new ventures. It stunts economic growth.

It is hard to imagine any reform of the capital-gains tax that would not be an improvement. Here are some possible alternatives:

1—Segregate capital gains and losses from ordinary income. Tax these segregated capital gains at the same rates as ordinary income, or at a flat rate calculated to maximize revenue. Allow deduction of losses against gains, and an indefinite carry-forward of losses until absorbed.

2—Cut the rate on long-term capital gains from a maximum of 25 percent to a maximum of 10 percent.

3—Follow the example of Britain. Don’t tax long-term capital gains at all. Or adopt the Swedish policy of tapering the tax off. (The Swedish taxpayer pays straight income tax on 100 percent of capital gains on assets held for less than two years, on only 75 percent of the gain on assets held between two and three years, on only 50 percent of the gain if the assets are held one year longer on only 25 percent if held one year longer still, and no capital-gains tax at all if the asset is held more than five years.)

4—At least allow the taxpayer to deflate his alleged capital gain to allow for the rise in the consumer price index over the period involved.

5—Allow the taxpayer a tax-free transfer of capital from any investment to another (a right that now applies only to his residence).

6—Enact some variation or combination of these reforms. ☼

## Lopsided Labor Law

January 21, 1963

Congress is being urged to do many things that are not urgent and some things that ought not to be done at all. But aside from a few forlorn proposals by individual congressmen, it has no plans for dealing with the most urgent domestic problem now facing the country—that of paralyzing strikes.

This problem is being treated for the most part either as if there were no real solution to it, or as if that solution were merely to move into still further government control—“fact-finding,” compulsory arbitration, or outright wage- and price-fixing. Most politicians and publicists simply refuse to re-examine the Federal laws passed in the ’30s and ’40s (particularly the Norris-LaGuardia Act and the Wagner-Taft-Hartley Act), or to ask whether these were not, perhaps, steps in the wrong direction. Suppose we had today the Federal and state labor legislative situation that existed prior to 1932 (together with local law enforcement) and either the East and Gulf Coast dock strike or the New York printers’ strike had been called?

Each of the New York newspapers would probably have tried to continue publication. It would have offered permanent employment, say to any competent printer, at a basic wage of \$145 a week. If the employers and the applicants were guaranteed adequate police protection, is there any doubt that the papers would get enough eligible applicants even from members of the union itself? And if mass picketing were again treated in law as what it is in fact—intimidation and

coercion—would members of non-striking unions abet the strike by “honoring” the picket lines?

### TOWARD WAGE-FIXING

Of course if the members of the striking union were really underpaid, as they contend, it would be impossible for the employers to replace them permanently with suitable substitutes. It is precisely because they know that other and less privileged workers would be eager to take over their “underpaid” jobs that they set up picket lines. What is constantly forgotten is that the coercion unions exercise is primarily coercion of their fellow workers.

The crippling strike of the Atlantic and Gulf Coast dock workers would not have been possible without the intimidation unions are permitted to exercise through picket lines and violence. In the dock strike that favorite remedy of so many employers and conservatives—the forced return to work under the “emergency” provisions of the Taft-Hartley Act for a “cooling-off” period of 80 days—has been exhausted. So leaders of the maritime industry, in despair, are calling for compulsory arbitration. No demand could be more shortsighted. If compulsory arbitration were imposed in the shipping industry, it would soon be imposed everywhere. Then demands for “equality of treatment” and “guidelines” would lead to outright wage- and price-fixing and a regimented and petrified economy.

### OUR DOUBLE STANDARD

What is urgently needed is not more laws but revision or repeal of bad laws now on the books. Unless we want to be forced step by step into more and more government control and coercion, we must restore free competition in the labor market. This means first of all enforcement of the common law against coercion and violence. It means prohibiting all picketing in numbers. It means ceasing to give unions power to bargain for anyone but their own members. It means, in brief, restoring free collective bargaining.

Some will think that it also means prohibiting industrywide unions, or any union extending beyond a single plant or corporation, and otherwise making unions subject to the antitrust laws. Such measures are of dubious necessity and dubious enforceability. But certainly labor law must be made more balanced and two-sided. *Either* we should enact right-to-work laws, or legalize the closed union. *Either* we should once more permit “yellow-dog” contracts, or prohibit compulsory union membership. The right not to join a union should be as clear as the right to union, and the right to work as clear as the right to strike. ☸

## Invitation to Inflation

January 28, 1963

President Kennedy’s State of the Union Message was a *tour de force*. It covered almost every conceivable project or dream. But it said not a word about the most urgent problem now facing the country—that of paralyzing strikes. We must assume either that the President does not consider the subject important, or that he is perfectly satisfied to give any labor union, big or little, power to silence a city’s newspapers, to halt its transportation, to immobilize the country’s shipping, or to shut down any industry whatever, until that union’s demands, no matter how unreasonable, are met.

Mr. Kennedy’s emphasis was on a tax cut of the huge amount of \$13.5 billion, phased over three years. But this is not to be accompanied by any corresponding reduction in expenditures. On the contrary, these are to be increased. A strange recommendation in the face of an already officially predicted deficit of \$8.8 billion in the current fiscal year. The President is *frankly* planning another deficit, even a series of deficits. His only restriction is that they are to be “manageable” and “temporary.”

### BROKEN PROMISES

But what assurance can we have that they will be either? What is considered “manageable”? How long is “temporary”? We have been living on such promises now for 30 years. They have never been kept. I cited the sad record in a *Newsweek* column of Nov. 21, 1953. It began with Roosevelt’s pledge of March 10, 1933: “I give you assurance that . . . within a year the income of the government will be sufficient to cover the expenditures of the government.” (The budget was never balanced in any of the twelve years that FDR was in office.) It came down to Eisenhower’s pledge of Feb. 2, 1953: “The first order of business is the elimination of the annual deficit.” (There was a deficit for fiscal 1953, 1954, and 1955.)

The net outcome has been 27 deficits in the last 33 years. As I concluded my column of ten years ago: “Each President began with pious promises of a budget balance, but there were always reasons why this could be done only in some indefinite future, and not now. Meanwhile the national debt keeps mounting and the purchasing power of the dollar keeps shrinking.”

Is there any reason to suppose that the even vaguer promises of Mr. Kennedy are more likely to be kept? It is not found in his own record. Secretary of the Treasury Dillon said on Oct. 17, 1961: “Let me repeat so there will be no mistake. The President intends to submit to Congress next January a balanced budget for fiscal 1963.” Mr. Kennedy did indeed, as promised, submit a budget in January 1962 ostensibly balanced for fiscal



1963, but now admits that there will be a deficit of \$8.8 billion.

### CRUEL DECEPTION

Nor does the present program of rising expenditures and huge tax cuts give any reason to hope for a budget balance within the foreseeable future. The tax cuts are not of a kind likely to stimulate increased revenues or maximum economic growth, but merely increased inflation.

And if the tax cut lets loose this inflation, it will be a cruel deception of the American people. Taxpayers will not be left with more purchasing power. It will be eaten up in higher prices. Inflation is itself a tax. If evenly spread, it would be equivalent to a flat-rate income tax and flat-rate capital levy without exemptions. But it is never evenly spread. It falls on the industrious and thrifty. It is escaped by nimble speculators.

It is true, as the President declares, that our Federal taxes are now oppressive and "too heavy a drag" on production and growth. But when such enormous sums must be raised, there is no magic reform that can make them unburdensome. The only cure is to slash our exorbitant expenditures. This would not be difficult. Our defense expenditures for the fiscal year 1964 are budgeted at \$55.4 billion. This means that non-defense expenditures, including social security, farm-price support, and foreign aid, exceed \$67 billion. All Congress needs is courage and a carving knife. ❁

## Deficits as a Policy

February 4, 1963

Mr. Kennedy is the first President who has ever openly advocated deficit-financing as a policy. He is *planning* a deficit of \$11.9 billion for the fiscal year 1964 and expects deficits in succeeding years. He lumps them all together by calling them a "temporary deficit." Eventually, because of the stimulus that a huge tax cut combined with increased expenditures is expected to give to the economy, these "transitional" deficits are expected to cure themselves and bring about a surplus.

Taxpayers will uneasily remember that they have heard all this before. They have been hearing it off and on, in fact, ever since the days of the New Deal. "It has taken courage for the Federal government to go into the red," said Franklin D. Roosevelt on July 8, 1938, "but it has been worth it." Somehow the promises that deficits would bring surpluses have never been kept. We have had 27 deficits in the last 33 years.

Is there any prospect that the theory will work better this time? Before we try to answer that question, let us see what is being proposed.

Mr. Kennedy is proposing that the Federal government spend in fiscal 1964 more than it has ever before spent in its history, in peace or war. He is asking for "administrative" expenditures of \$98.8 billion. This tops even the \$98.4 billion of the peak war year, 1945. In the cash budget (which includes old-age pensions, etc.) he proposes to spend the unparalleled sum of \$122.5 billion.

### NON-DEFENSE SPENDING

Throughout his Budget Message the President gives the impression that this record budget is brought about mainly by increased defense expenditures. That thesis cannot be maintained. True, he is proposing defense expenditures for 1964 of the record amount of \$55.4 billion. But as total cash expenditures will reach \$122.5 billion, this means non-defense expenditures of \$67.1 billion.

And non-defense spending has risen faster than defense spending. If we compare 1964 with 1954, we find that while total defense expenditures have increased \$8.4 billion, non-defense expenditures have increased \$22.9 billion and, counting social security, etc., \$42.2 billion.

If Congress is sincerely looking for places where it can cut the budget, it need not look far. It might look at the scheduled expenditures of \$4.2 billion for space research connected with defense, at the \$3.7 billion scheduled for foreign aid, at the \$5.8 billion for farm programs, at the \$6.7 billion for "commerce and transportation," at the \$1.1 billion for housing subsidies, at the \$6 billion for veterans' programs, and at the glorious \$27.4 billion for "health, labor, and welfare."

### NO FOURTH DIMENSION

The President speaks of all these and many more programs as "a necessary payment on future progress." He insists that others "are for activities which will promote increased productivity and economic growth, yielding substantial benefits in the future." But this is to talk as if the money for these programs came out of some fourth dimension. It is to forget that it is taken away from the taxpayers. It does not "meet more national needs." It causes every tax-paying family to meet fewer of its own needs. It leaves less for private persons and private business to invest in the future, in increased productivity or economic growth.

So far we have taken the budget estimates at face value. But suppose, as there are strong reasons for

thinking, that expenditures are even more than \$98.8 (or in cash, \$122.5) billion; that revenues are less than \$86.9 billion, and that the deficit is more than \$11.9 billion? This is more than possible. A year ago the President estimated a surplus for the current fiscal year of \$500 million. This has now become an expected deficit of \$8.8 billion, because expenditures are \$1.8 billion more and revenues \$7.5 billion less than he estimated.

The budget that Mr. Kennedy has submitted, in brief, is irresponsible. Even if the deficit is no greater than the \$11.9 billion he estimates, the course he proposes of raising expenditures and cutting taxes can lead only to more inflation, and will undermine confidence in the world's anchor currency, the dollar. ☸

## A Dictated Settlement

February 11, 1963

While the attention of Congress is being diverted by fantastic proposals to slash taxes in the face of an already huge prospective deficit, ominous developments have taken place in the field of labor.

The Atlantic and Gulf coast dock strike, which had kept 100,000 people out of work for more than a month, tied up nearly 700 ships, caused untold spoilage of fruit and other cargoes, and total damage estimated at \$700 million to \$1 billion, has been "settled." It remains to be seen whether the settlement doesn't cause even more damage in the long run than the strike.

This settlement was dictated by the Kennedy Administration. The terms were heavily weighted in favor of the union against the industry. On the wage and "welfare" side they granted the union a 39-cent-an-hour package over two years—far in excess of any "guidepost" even the President's Council of Economic Advisers had dared to propose. (Dock workers' pay has averaged around \$3.65 an hour.) But the chief issue involved was the outrageous featherbedding of the ILA union, which the employers had sought to mitigate. The President's three-man board simply swept this issue under the rug by recommending that it be put off for a two year "study."

### SOME PROTESTS

This highhanded action has at least drawn a vigorous protest. The *Wall Street Journal* writes: "The same government which blew its top at a steel company for announcing modest price increases less than a year ago, and threw its full force into rolling back those increases . . . apparently thinks the dock settlement

is just fine. President Kennedy says he is 'gratified.' In a sense the government should be gratified, for the government dictated the settlement; there is no other word for it. . . . Senator Morse and his colleagues on the President's three-man board took the bulk of the union's demands and the government told the companies to knuckle under. . . . The upshot is a settlement that settles nothing and therefore may well prepare the way for more vicious strikes later."

The National Association of Manufacturers calls the settlement imposed by the Wayne Morse board "a bare-knuckled display of government power unsanctioned by law."

The *New York Journal of Commerce* calls the settlement a "crushing victory over management," and adds: "Mr. Kennedy might just as well have raised the tariff, imposed a tax on exports, or simply raised taxes on firms engaged in foreign commerce to the tune of \$18 million to \$26 million a year. . . . It is the President himself who has finally given the answer to the question of whether he would crack down on excessive labor demands with the same ardor that he cracked down on steel price increases. It can be stated in three flat words: he will not."

### BUYING MORE STRIKES

Where will Mr. Kennedy go from here? When it was pointed out to him that if he dictated steel prices he might logically be asked to dictate all other prices, he disavowed such an aim and treated his crackdown as an isolated episode. But having dictated a thumping wage increase for a featherbedding union, how can he deny an equal award to other unions?

The Kennedy Administration has been toying for a long time with the idea of compulsory arbitration of labor disputes. This has been shown in the Council of Economic Advisers' notion that it can set up wage-determining "guideposts," in former Secretary Goldberg's statements and interventions, and in present Federal interventions. But conservatives and liberals who rightly fear this outcome are confused and divided among themselves. Some ask for antistrike legislation. Others suggest putting the unions under the antitrust laws. But the real need is simply to restore freedom of bargaining. Bargaining cannot be free as long as the law permits mass picketing or any other form of physical intimidation, coercion, or violence. And it cannot be free as long as employers are legally compelled to bargain solely with specified unions, or as long as the compulsory union shop is explicitly sanctioned by Federal law. ☸

## How We Choke Incentive

February 18, 1963

The President's special message to Congress on tax reduction and "reform" rests on a network of outworn economic fallacies. Its basic assumption is that the way to reduce unemployment and increase economic growth is to cut the tax rates on the lower income groups and to squirt more "purchasing power" into the economy through huge government spending and huge deficits.

The truth is that enactment of the President's program would bring on inflation and imperil the dollar as a world currency. There is no reason to suppose that it would either reduce unemployment or promote economic growth. Unemployment is caused by discoordination of the wage-price system. As long as unions are granted their present powers to extort wage rates beyond the level of marginal labor productivity, they will perpetuate and increase unemployment in the very face of inflation. So far as economic growth is concerned, it can be promoted only by policies less hostile to profits, risk-taking, success, and investment. Only encouragement to investment can raise wages.

### PENALIZING SUCCESS

Most of the tax cuts recommended by the President are not calculated to encourage business or employment to expand. They increase, rather than diminish, the incentive-stifling progression in the tax-rate schedule. As the President himself points out: "The overall savings are proportionately highest at the lower end of the income scale"—nearly 40 percent for those with incomes of less than \$3,000, and less than 10 percent for those with incomes in excess of \$50,000. And the so-called "reforms" largely take back whatever relief the tax-rate cuts do give to the middle and upper income level taxpayer.

As one investment house (Aubrey G. Lanston & Co., New York City) bitterly puts it: "As far as individuals are concerned, the plums in this tax package would go to the person who doesn't own his own home; doesn't save and provide capital to American industry through stock ownership; doesn't carry his proportionate share of the support of our churches, hospitals, colleges, and charitable causes; doesn't pay much in taxes to support city schools and other local services and to pay for state government; and doesn't happen to fall into ill health. Nearly 1 million taxpayers would be removed from the tax rolls, in fact, to vote themselves greater future benefits without even the need to fill out and turn in a nominal tax return."

### A 50 PERCENT TOP

With a few exceptions the "reforms" recommended by the President would make income-tax paying more unfair as between different taxpayers rather than less. The exceptions are the proposal to allow an indefinite carryover of capital losses, the proposal to remove the present limit on deductions for catastrophic medical expenses, and the proposal to permit those who receive widely fluctuating amounts of income from year to year to average them out for tax-rate purposes. This last reform would be much less necessary if it were not for our steeply graduated tax-rate schedule—particularly the rates over 50 percent.

The proper course for Congress would be to concentrate on slashing nondefense expenditures, to balance the budget at present tax levels, and to postpone the whole "tax reduction" program as such. It is true, as the President concedes, that our present tax burden "reduces the incentive for risk, investment, and effort thereby aborting our recoveries and stifling our national growth rate." But the way to reduce it is to slash the spending that makes it necessary, not to invite deficits and inflation.

While waiting for the appropriation committees to do this, revenue-raising committees of Congress might well go ahead now with tax *reforms* but real reforms, designed to maintain revenues while reducing deterrents to economic growth. There is room to mention only one such reform here. Slash all income-tax rates above 50 percent to that level. All these rates together bring in less than \$1 billion a year, or less than 1 percent of what the government spends. Yet it is impossible to estimate how much they choke incentive and discourage investment. ☸

## Legalized Labor Chaos

February 25, 1963

Some day, presumably, the New York newspaper strike will be settled. But it is unlikely that the terms of the settlement will be such as to promote the prosperity of the papers. Hence it is unlikely that the terms will be in the long-run interests of the employees themselves.

The precedent established in the month-long dockers' strike is ominous. Wholly apart from the fact that the wage boost forced on the shipping industry by the extralegal Presidential board went far beyond the "guideposts" set even by the Council of Economic Advisers, the real issue of featherbedding was untouched. The settlement, therefore, tends to entrench make-work practices and to discourage all future efforts toward



efficiency. The real issue in the New York newspaper strike also is union insistence on bogus and featherbedding and preventing economies through modernization.

### THE MUZZLED PRESS

There is mounting concern within the newspaper profession. James Reston, chief of the Washington bureau of *The New York Times*, wrote in a column intended for syndication:

“The present system is intolerable for the public, the unions and the publishers alike. The President of the U.S. cannot censor the New York papers. The Congress of the U.S. is specifically forbidden to abridge their freedom . . . but Bert Powers, the boss of the New York printers, cannot only censor them but shut them down. What is ‘free’ about a press that can be muzzled on the whim of a single citizen?

“This is anarchy. . . . The papers will have to be published, in New York if possible, elsewhere if not; in union shops if possible, in non-union shops if not. And they will have to be distributed through the mails if necessary. The present situation cannot be accepted in a democratic society. . . . Values and duties have become so confused that even the suggestion of publishing without the consent of the unions is now regarded as a declaration of war. How the old editors who founded our press would have hooted at that!”

The *Times*, by sending out an order to kill this column, showed how far intimidation has gone.

Why didn't the New York papers continue publication, strike or no strike, instead of allowing themselves to be shut down and silenced for more than two months? Continued publication was not *prima facie* impossible. When, more than three years ago, a strike hit the *two* daily newspapers of Portland, Ore., the papers continued publication the next day, first combined, and later again as separate papers. They have continued publication, though the strike has never been settled.

### WHY NO PUBLICATION

Why didn't the New York papers follow suit? Probably for three main reasons. First, fear of the word “strike-breaking.” Second, fear of vandalism and picket-line violence. Third, fear of being cited as violators of the Wagner-Taft-Hartley Act.

The Federal government is moving toward compulsory arbitration of labor disputes. Its dictated settlement of the dock strike reveals the pattern. It allows a situation to develop in which no other solution seems possible. It affects to be following a “hands-off” policy, but under existing laws it is intervening on the side of the unions, and even of union intimidation, every day.

The Norris-La Guardia Act encourages picket-line violence. It denies injunctive relief to employers who

are suffering irreparable injury from clearly unlawful conduct. The Wagner-Taft-Hartley Act gives unions a privileged status enjoyed by no other private groups. It forces employers to bargain exclusively with them, even when their demands are beyond all reason. The law is hypocritical. It makes it “an unfair labor practice for an employer . . . by discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization” and then explicitly sanctions imposition of the compulsory union shop.

There will be labor chaos as long as such legislation remains. How long will it take for the President and Congress to recognize this? ☸

## How to Help the Poor

March 4, 1963

On the argument that it will put zip in the economy and reduce or wipe out unemployment, the President and his advisers are planning to increase spending and cut taxes, and so bring about a budget deficit for the next fiscal year of some \$12 billion. On the argument that it will help “the little fellow,” as well as increase “mass purchasing power,” the biggest tax slashes are to be made on incomes of \$3,000 or less and the smallest percentage cuts on the largest incomes. As, in addition, nearly a million low-bracket taxpayers are to be removed from the tax rolls altogether, the net effect will be to increase tax discrimination against those who earn the higher incomes.

Let us assume that neither of these proposals is designed for mere vote-catching, but is made with perfect sincerity. It is nonetheless true that both of them rest on flagrant economic fallacies. Budget deficits would hurt, not help, workers and people with low incomes. Punitive taxation on people with higher incomes, and limitation or disallowance of honest deductions (stigmatized as “loopholes”) must also hurt, not help, workers with low incomes.

### INFLATION IS A TAX

Cutting taxes on low incomes, at the cost of a huge budget deficit, will *not* increase the purchasing power of low-income groups. For if the deficit is financed by borrowing from the banks and increasing the money supply (as it almost inevitably will be), it will create inflation. It will drive up prices. And the higher prices will eat up any increase in nominal dollar purchasing power. The lower-income groups will not be able to buy



any more with their increased supply of depreciated dollars than they could with fewer but better dollars. Their “increased purchasing power” will fade away.

Equally fallacious is the idea that budget deficits create prosperity and increase employment. They do mean inflation. They do raise prices. But they can increase employment only to the extent that they lower real wages—i.e., only to the extent that the rise in prices is not offset by an equal or greater increase in wage rates. Any prosperity brought by inflation is at best evanescent. It can be kept going only by greater and greater doses of inflation.

The belief that deficits cure unemployment got a crushing refutation in the '30s, when for ten years an *average* annual deficit equivalent to \$19.7 billion today (as a percentage of GNP) was accompanied by *average* unemployment of 18.6 percent of the labor force.

### DON'T PUNISH SUCCESS

Punitive taxation of corporations and of high-income earners also hurts workers and low-income earners. For whatever hurts profits and capital accumulation, whatever discourages saving and investment, means fewer jobs, makes labor less productive, and makes real wages lower than they otherwise would be. Again and again in the last year the Administration has deplored whatever hurts “initiative, risk-taking, and effort.” But its spending and tax recommendations bear little relation to this verbal concern.

A program that would truly help workers and other low-income groups would be almost the exact opposite of the one the Administration is proposing. It would slash spending enough to balance the budget at present revenue levels. For it would recognize that all expenditures have to be paid in one way or another; that a deficit is paid for by inflation; and that inflation is a peculiarly vicious form of tax, falling most heavily on workers.

A program truly designed to help wage-earners would terminate the punitive tax rates on high incomes. It would slash such rates immediately to a top level of 50 percent, on the ground that anything above that is *prima facie* confiscatory and a profound discouragement to initiative, effort, risk-taking, capital accumulation, saving, and the investment that increases employment, productivity, and real wages. For the same reason it would mitigate estate taxes, capital-gains taxes, and double taxation of dividends.

In brief, it would halt all punitive policies and approve a tax program to maximize production. ☸

## Hellerious Economics

March 11, 1963

What is the rationale behind Mr. Kennedy's extraordinary proposal that, in the face of a huge deficit of nearly \$9 billion in the current fiscal year, we should increase spending, drastically cut taxes, and bring about still another deficit of nearly \$12 billion in fiscal 1964, plus an indefinite number of deficits thereafter? On its face, this program seems the height of fiscal irresponsibility. How can it be defended?

The most elaborate defense of it is to be found in the President's annual Economic Report published on Jan. 21. The report consists of a twenty-page message to Congress signed by the President and a 268-page report of the Council of Economic Advisers (164 pages of text, 104 pages of tables) signed by Walter W. Heller as chairman. It is impossible to say how much Mr. Kennedy's policies are based on chairman Heller's economic theories, or how much the theories are an attempt to rationalize the policies that Mr. Kennedy has decided to adopt. In either case the outlook is ominous.

For the theories set forth in the full report, and summarized in the President's message, are utterly fallacious. And if policies based on them are persisted in, they must imperil the dollar and ultimately lead to a disastrous inflation.

### WAGE DISTORTIONS

Mr. Kennedy, laudably, wants to cure unemployment. But he never mentions, and the whole Economic Report never mentions, the main cause of unemployment, which is the excessive wage rates successfully insisted on by some unions in key lines. Practically all unemployment is attributed by the President to “insufficient demand.” And insufficient demand is always interpreted to mean insufficient money supply. So unemployment is always to be cured by more government spending and more money, while wage-rate distortions are systematically ignored.

The way to cure unemployment and give zip to the economy, on this theory, is to have huge and continuous deficits, to increase spending, and to cut taxes. “The main block to full employment,” says the President, “is an unrealistically heavy burden of taxation. The time has come to remove it.” The President speaks as if the burden of taxation had nothing to do with the amount of government spending. This spending, in fact, is to be increased. The question may well arise in the reader's mind: why not abolish taxes altogether? Then there would be no block to full employment whatever.

### 'DEFICITS FOR STRENGTH'

Indeed, Mr. Kennedy is not daunted by paradox. He tells us that if we fail to cut taxes, we will slide into recession, and then "the cash deficit for next year would be larger *without* the tax reduction than the estimated deficit *with* tax reduction." We have entered the world of Alice in Wonderland, where the "prudent" and "responsible" thing is planned deficits, and where "if we were to try to force budget balance by drastic cuts in expenditures . . . we would not only endanger the security of the country, we would so depress demand, production, and employment that tax revenues would fall and leave the government budget still in deficit."

But what if the Heller theory fails? What if heavy unemployment persists (as in the '30s) even with constant huge deficits? What if the vague hope is not realized that some miraculous prosperity will balance the budget in spite of reduced taxes? Mr. Kennedy himself concedes that "if we were currently straining the limits of our productive capacity . . . tax reduction would be an open invitation to inflation, to a renewed price-wage spiral." What if this inflation occurs (as is altogether probable) even under present conditions of more than 94 percent employment?

It would be flattering to call this Heller-Kennedy budget theory Keynesism. It carries the logic of deficits to lengths that would have appalled Keynes himself. For Keynes (as Per Jacobsson has just reminded us) at least recognized that excessive *real* wage rates make full employment impossible.

The Heller-Kennedy spend-more-and-tax-less theory can lead only toward fiscal and monetary chaos. ☸

## The Growth Mania

March 18, 1963

The American public, as H.L. Mencken used to point out, lives through a succession of crazes. In the economic field the last generation has lived through many. Once the great watchword was "full employment." Now the supreme goal is "economic growth." Even the American Bankers Association has just held "A Symposium on Economic Growth."

If we took the word "growth" to be merely a shorthand expression for an improvement in economic conditions, this would be a vast improvement over previous catchwords. But the "growth" mania rests on a special set of assumptions and has taken a peculiar form. It assumes that there is something called "the gross national product," or "GNP," that can be precisely measured. Anyone who has seriously studied how these

statistics are compiled knows that they are full of arbitrary and questionable assumptions. GNP is measured in a dollar that is itself constantly fluctuating in value. The GNP can be pushed up to any amount simply by inflating the currency enough.

Dollar fluctuations are only one of the dubious elements. Government expenditures are counted as part of GNP. So if the government seizes half of Peter's income and pays it over to Paul, the GNP total counts the addition to Paul's income but not the subtraction from Peter's. GNP is built out of arbitrary decisions as to what activities are "productive" and what are "unproductive." On the one hand it includes only goods and services that pass through the market. On the other hand it involves double counting at a hundred points.

### WHY 4 PERCENT?

Every country measures its GNP in a different way. Every GNP figure is an arbitrary estimate subject to error. The estimate of Communist countries, with no free-market guides, is wholly unreliable. Yet the growth zealots assume that all these estimates can be precisely compared. They even assume they can precisely measure and compare annual percentage *rates* of growth. And for some reason they have made their goal a precise annual *rate* of growth. Thus President Kennedy, addressing the American Bankers symposium, recommends "pushing our economy to 4 percent [annual rate of growth] instead of 3 percent." This, he adds, "might total over the next ten years in today's prices \$400 billion more in output of goods and services." But why just 4 percent? Why not 5 percent or 6 percent, which would mean many hundreds of billions more still in goods and services?

And why a fixed *rate* of growth at all? No individual sets such a goal for his own income. If Paul has an income of only \$1,000 this year, he will hardly be satisfied with \$1,040 next year. He wants to jump to \$5,000 or \$10,000 right away, or as soon as possible. If Peter already has an income of \$25,000, he may not fight very hard for \$26,000 next year, or any increase at all.

### TELEVISION RECORD

Does a specific industry want or need to grow just 4 percent a year? In a *Newsweek* column (March 2, 1959) I pointed out that the output of TV sets increased 2,757 percent between 1946 and 1947, 387 percent between 1947 and 1948, 211 percent between 1948 and 1949, and 146 percent between 1949 and 1950. *And then "growth" stopped entirely.* So what? The U.S. has more and better TV sets than any country in the world.

What we need is not some fixed national "rate of growth" established by the fiat of government officials,

but freedom for each of us to improve his own economic condition as much as his energy and talents allow.

The true role of government is to protect life and property and to stop killing incentives. It will not promote growth by cutting taxes while maintaining or increasing huge government spending. That can only bring about deficits, inflation, and debasement of the dollar. It can best promote growth by preserving a sound currency, by ensuring free and fluid markets in goods and labor, and by encouraging saving and investment. It is above all investment, which puts more and better machines in the hands of the workers, that increases their productivity and wages and promotes "economic growth." ⚙

## Inflation as Cure-All

March 25, 1963

Unemployment took a turn for the worse in February, rising to 6.1 percent of the labor force, the highest in fifteen months. On the day this was announced there came a chorus of demands for a quicker and bigger tax cut, more government spending, bigger deficits, more inflation.

President Kennedy, following Labor Secretary Wirtz and AFL-CIO president George Meany, warned that this "intolerable" unemployment would grow worse unless Congress quickly approved his tax-cut proposals. The Democrats on the House-Senate Economic Committee called for a \$6 billion tax cut this year instead of the President's own plan for a mere \$3 billion.

These Democrats, under the leadership of Senator Douglas of Illinois, support the Administration's goal of a \$10.3 billion net tax reduction over three years, but feel that the amount allocated for 1963 is too small. "The largest doses should be given when the patient is the sickest," they say. And they add: "The widespread demands for stimulative tax reductions are, by the same token, demands for stimulative monetary action. Monetary policy must now help fiscal policy to do the stimulative job which, unfortunately, the monetary authorities haven't done."

This is an unmistakable demand for outright and reckless inflation.

### WHY UNEMPLOYMENT?

Before it allows itself to be stampeded, Congress should ask a few questions. Why has unemployment gone to the highest level in fifteen months? Why is it 24 percent higher than the average for the Eisenhower Administration? (In the eight years from 1952 through

1960 unemployment averaged 4.9 percent.) Is this the way the New Frontier economics has "got the country moving again"?

What is the trouble? Is the money supply too small? It has increased 15 percent since 1953, when unemployment was only 2.9 percent. Haven't there been enough deficits? The deficits since the end of fiscal 1953 have averaged \$3.2 billion a year. And we have recently been doing much better than that. The deficit for fiscal 1961 was \$3.9 billion, and for 1962, \$6.4 billion. For the present fiscal year we are promised a deficit of \$8.8 billion. and for fiscal 1964 of about \$12 billion. Why, with all this new "purchasing power" pouring into the economy, does unemployment increase?

Could it be that "insufficiency of purchasing power" is not the cause of the unemployment? Could it be that unemployment is the result of encouraging unions to gain excessive demands? Isn't the unemployment a sign that, in the lines in which it occurs, wage rates and labor costs are too high? Are some unions pricing their members out of the market?

### DOUGLAS VS. DOUGLAS

This is what economists contend. And Paul H. Douglas, when he was a professor of economics, and before he got Senatorial ambitions, was among them. In 1934 he wrote a massive book called *The Theory of Wages*, in which he arrived at the conclusion that "if wages are pushed up above the point of marginal productivity, the decrease in employment would normally be from three to four times as great as the increase in hourly rates so that the total income of the working class would be reduced."

Applying this to the present situation, may not our unemployment of 6 percent indicate that wage rates are 2 percent higher than the productivity level that would permit full employment and maximum payrolls? (As 2 percent is an *average* figure, the assumption would be that most wage rates are not too high but that a few wage rates are much too high.)

Why is Senator Douglas, why is every member of the Kennedy Administration, completely silent on this possibility? Why does no one dare to ask whether full employment might not be restored by a little wage adjustment? Why is everyone shouting for tax reduction, spending increases, deficits, more inflation, all of which threaten the future of the dollar?

Of course we need tax cuts, particularly of the taxes on investment and production. But the only way to get them without courting a disastrous inflation is to slash intolerable government spending. ⚙



## Less Coffee in the Cup

April 1, 1963

In the summer of last year, at the United Nations, the representatives of 71 countries attended a conference on coffee. They drew up an elaborate agreement to “stabilize” (i.e., to hold up) the price of coffee. This involved fixing export quotas for 36 producing nations. This International Coffee Agreement was signed on behalf of the U.S. Government on Sept. 28. By the end of November, 54 governments had signed. But the agreement must still be ratified by the U.S. Senate. On March 12, Under Secretary of State George C. McGhee argued before the Senate Committee on Foreign Relations in favor of such ratification.

The argument in favor of the agreement, as stated by Secretary of State Dean Rusk, is that it “offers the best prospect of arresting any further decline in world coffee prices, thus helping to assure stability in foreign-exchange earnings of coffee producers in some 35 developing countries in Africa, Asia, and Latin America.” It is chiefly intended to help Latin American producers, particularly in Brazil and Colombia, which respectively account for 39.2 percent and 13.1 percent of total world exports. It would be chiefly at the expense of U.S. consumers, who import 51.7 percent of total world imports. Of the other 70 importing nations, the most important are France, with 9 percent of the total, and West Germany, with 8 percent.

### CROPS DESTROYED

Will the agreement in fact help to “stabilize” coffee production and prices without excessive cost? Neither theory nor experience gives any reason for supposing that it will. Listen to the judgment of Karl Brandt, director of Stanford University’s Food Research Institute, in *Challenge* magazine (February 1963):

“Such price-fixing . . . while it might mitigate the violence of short-term price fluctuations, inevitably caused profound and serious dislocations for production, processing, stockholding, and consumption. . . . The ‘stabilization’ of cotton prices in the U.S. has not only frozen production in high-price locations, but it has spurred and accelerated cotton production in other countries. And 60 years of efforts to stabilize coffee prices have led to such extreme methods as destroying within a period of twelve years a quantity equivalent to three years’ total world coffee consumption. This did not appreciably help Brazil or Colombia, but instead spurred competitive production in other parts of the world, primarily in Africa. . . . International commodity agreements, at best, do not offer more than a temporary sedative that may give the political sensation of relief.”

### OUR DOUBLE STANDARD

Enormously complicated bureaucratic controls will have to be set up *within* each nation in order to carry out this international coffee agreement. It fixes export quotas for 36 countries. But in order to comply, each of these countries will have to fix production or acreage quotas for each of its thousands of individual producers. Thus the marginal producers, which a free market would eventually eliminate, will be frozen in. The inefficient producers will keep going. Costs as well as prices will be kept high. Such agreements not only eliminate competition between nations, but competition between individual producers within nations.

It is bad enough when the U.S. penalizes its own consumers in order to benefit its own marginal producers of wheat or cotton. It is more ironic when it proposes to penalize its own consumers in order to benefit the marginal coffee producers of other countries, and to do so by conspiring to forbid a free market. McGhee admits that the “international” coffee agreement “would collapse without our participation.”

But the most bitter irony of all is that the U.S. Government has signed a document proposing to resort, and to an enormously greater extent, to precisely the practices for which it puts American businessmen in jail. The double standard was never more flagrantly or cynically applied. Price-fixing in industrial products is condemned and punished as a crime. Price-fixing in labor, or in farm products, domestic or foreign, is lauded and enforced as desirable, benevolent, and imperative. ☸

## The Right to Publish

April 8, 1963

Let us hope that the settlement of the New York newspaper strike will not be followed merely by a sigh of relief but by absorption of its elementary lessons and action to prevent similar calamities.

It has been a strike in which everybody lost. There will be no victors. Let us pass over the incalculable loss to the New York public in being deprived of the daily news for nearly four months; the losses of small newsstand owners, department stores, specialty stores, theaters; the staggering losses of the newspapers themselves, and the losses that their 20,000 employees, including the strikers, can never make up. Let us concentrate on one question: how was it possible for one private citizen, or at best a small handful of men, to do what Congress and the President are expressly forbidden to do in the Constitution—not only to abridge the



freedom of the press, but to shut it down entirely for nearly four months?

In the enormous discussion of the New York newspaper strike, the answer to this question was almost never frankly given. Yet that answer is clear. Partly this result was possible because Federal law gravely abridges the bargaining freedom of individual workers and of employers. It is so drawn as in effect to deny them injunctive relief from irreparable injury. The main reason the newspapers stayed closed was the simple fear of their managers that any attempt to publish would lead to violence and bloodshed.

### FEAR OF VIOLENCE

It is greatly to be deplored that no one attempted to publish. Even if the fears had proved justified, at least the public would then have recognized clearly that what was keeping the newspapers shut down was the threat of union violence and vandalism, and the inability or unwillingness of the city authorities to protect the workers or the plants.

Those who are tempted to accuse the newspaper owners of timidity and cowardice, however, should seriously consider the risks they faced. Victor Riesel, in a recent syndicated column, gave details from unpublished accounts by Federal investigators of "shootings, slashing of tires, planting of nails on roadways, rubber truncheoning of opponents; beatings, breaking of arms and some really major assaults too numerous to list here."

Yale & Towne's Philadelphia plant, in late 1961, courageously and successfully stayed open during a stormy five-and-a-half-month strike, but had to organize its defense with the care of a military operation. To collect evidence it took 2,000 still photographs and 6,000 feet of motion-picture film during the strike. Its operations (I quote from the October issue of *Mill & Factory*) "included . . . a big magnetic broom to pick up nails thrown by strikers in the main driveway of the plant during the night hours. The broom picked up over a thousand nails in one day."

### THE KOHLER STRIKE

Those who want an illuminating case history, showing how even an "honest" union like the United Automobile Workers operates, should read *The Kohler Strike* by Prof. Sylvester Petro of the New York University School of Law (Regnery, 1961). There they will find described in detail the techniques of mass obstruction, violence, and vandalism, and how those who try to return to work can be frightened by vicious telephone calls in the night, by acid sprayed on their cars, by paint bombs hurled through their living-room windows.

The remedy? Mainly enforcement of the laws against violence. As Petro writes: "There are plenty of police. If hundreds are used to keep order when it is a question of protecting Communist bullies visiting the United Nations in New York City, it is not asking too much to have adequate police protection against union bullies." It will help, too, if all picketing in numbers is outlawed. Among other measures Petro suggests: "The special privileges of compulsion granted unions by the NLRA must be repealed, and personal freedom must be restored to workingmen. . . . The duty to bargain must be repealed, for it cannot be enforced without reaching a result which nobody wants: namely, agreements, compelled by governments." ❁

## For True Tax Reform

April 15, 1963

Opinion is beginning to clarify about the President's tax cut and tax "reform" proposals, but a good deal of ambiguity remains.

Practically everybody favors a tax cut. But the tax cut advocates fall into at least five groups: those who want a tax cut (1) with *increased* expenditures; (2) with *unchanged* expenditures; (3) with a *smaller* cut in expenditures; (4) with an *equal* cut in expenditures, and (5) those who favor a tax cut only with a big enough cut in expenditures to balance the budget. The whole discussion would be clearer if everybody stated frankly to which of these five groups he belonged.

It is impossible to discuss taxes realistically in isolation from the level of expenditures. Too many people seem to have forgotten that the only reason we have to pay taxes at all is to meet government expenditures. And we do have to meet them. The planned \$12 billion deficit for 1964 has been well described as a plan to borrow \$12 billion from the American people to pay for their own tax cut.

But we can ask ourselves this hypothetical question: given the necessity of raising the same amount as existing taxes raise, could a better tax system be devised for doing it? This is the question of tax *reform*.

### PUNITIVE RATES

True tax reform would be far more thoroughgoing than, and quite different from, the "reforms" the President has advocated. True reform would reconsider our balance between direct and indirect taxes. And it would re-examine the whole principle of the "progressive" income tax.

This device rests ostensibly on grounds of “social justice.” Yet it embodies the morally dubious assumption that a majority has a right to impose on a minority punitive tax rates that it would not dream of accepting for itself. The moral, legal, and economic harm done by the application of this discriminatory principle has been analyzed at length by F.A. Hayek, Milton Friedman, and other economists.

Our steeply graduated rates have not been successful even in raising revenue. It has been calculated that a flat income-tax rate of 23½ percent, with present exemptions, would raise as much revenue as the whole present scale of rates ranging from 20 to 91 percent. It has also been calculated that the basic rate of 20 percent yields 85 percent of the entire personal income-tax revenue, which means that the whole progression up to 91 percent yields only 15 percent. Finally, all the progressive rates above 50 percent yield less than \$1 billion—i.e., less than 1 percent of our total revenues (including those from flat-rate social-security taxes) and enough to run the government for only four days.

### DESTROYING INCENTIVES

Yet the harm that these punitive rates above 50 percent do in destroying incentives to effort, production, and investment, and in siphoning off the major part of the funds otherwise available for investment, is incalculable. Our present tax system is probably more responsible for our present slow rate of economic growth, of which the Administration is constantly complaining, than any other factor.

Public opinion is not yet prepared to accept a simple proportional income tax. But wiping out all tax rates above 50 percent would give an immense impetus to effort, risk-taking, and investment. The moral argument for such a ceiling is that any tax above 50 percent is *prima facie* confiscatory. As former Under Secretary of the Treasury Roswell Magill has put it, “a taxpayer’s interest in earning a dollar of additional income should at least equal the government’s.” The economic argument for such a ceiling is that it would do more in the long run to increase the real disposable income of workers and others in the lower income brackets than any temporary cut in their own tax rate.

Such a ceiling might possibly in the first year result in a trifling loss of revenue, but it would be certain in the long run to bring a substantial increase in revenues.

This 50 percent top should, of course, apply not only to personal income taxes, but to corporate taxes and estate taxes. ☼

## Do Deficits Make Jobs?

April 22, 1963

The dominant argument of the Administration for tax cuts and bigger deficits is that these deficits are necessary to speed up “growth,” to reduce unemployment, and to save us from an economic tailspin.

This theory, now treated in Administration circles as an axiom, receives no support from experience. I have several times in this column referred to its crushing refutation in the '30s. In the ten fiscal years from 1931 to 1940, inclusive, there was a deficit every year. The average annual deficit was 3.6 percent of the gross national product of the period, equivalent today to an annual deficit of \$20 billion. Yet the average unemployment in that ten-year period persisted at 18.6 percent of the labor force. The same percentage today would mean nearly 14 million jobless.

Now the Machinery and Allied Products Institute, in testimony presented by its economist, George Terborgh, to the Joint Economic Committee of Congress, has made a careful and detailed statistical analysis of the relation of budget deficits and surpluses to changes in the GNP for the sixteen-year period from 1947 to 1962 inclusive. The comparisons are broken into three-month periods. Surpluses and deficits are measured in terms of the “national-accounts” budget, which the Administration favors, instead of the conventional “administrative” budget.

### SIXTEEN-YEAR RECORD

What does the comparison show for these 64 quarter-years? “Of 51 quarters with a rising GNP, more than half (28) were associated with a Federal surplus, 23 with a deficit, while of 13 quarters with declining GNP, nearly all (12) were associated with a deficit.

“It may be objected that there is a lag between the budget position and the response of the economy, hence that we should ‘lead’ the former by a reasonable period. If we lead it by six months, the picture is not greatly altered. Of 51 quarters with rising GNP, 24 show budget surpluses in the second quarter preceding, 27 deficits. Of 13 with falling GNP, 7 show surpluses, 6 deficits.”

Let us interpret these comparisons. If Federal budget deficits really stimulated the economy, and surpluses depressed it, as the Administration assumes, we should expect to find expansion predominating during deficit periods and contraction predominant during periods of surplus. We find no such correlation. On the contrary, for simultaneous comparisons we find a slight positive correlation between *surpluses* and rising GNP (or deficits and declining GNP).

## EFFECT OF WAGE RATES

But we did not need the statistical record of the '30s, or of the sixteen years from 1947 through 1962, to show us that the theory of growth by deficits or reducing unemployment by deficits was unsound. The only thing that deficits can produce is inflation. Inflation can temporarily stimulate an economy (at a high cost in the long run) only if, during the inflation, wages and other costs stand still, or at least rise less than prices. In that case the restoration of profits, or of the prospect for profits, can stimulate increased production and re-employment.

But this result is altogether unlikely today, when unions are encouraged to make ever-greater demands and when strikes are encouraged and even subsidized by legislation that takes the chief risks out of strikes and even pays unemployment insurance to strikers.

Unemployment could be sharply reduced, without deficits and without inflation, if unions ceased to be encouraged to make demands that price their members out of the market.

Unfortunately Terborgh, in spite of his own statistical results, comes to the wrong conclusion that what is really needed to stimulate the economy is to increase the money supply by monetizing "enough" of the deficit. This is an inflationary recommendation, particularly ill-advised in our present gold and balance-of-payments dilemma. But Terborgh is right in insisting that if there is to be tax reduction, "first priority should be given to two long-overdue reforms, a reduction in the corporate rate and a scale-down of high-bracket personal rates." ❀

## Price Control by Warning

April 29, 1963

The President's statement on the steel price increase this April was very moderate compared with that of last April. But even this year's statement contained many ambiguities and left some crucial questions unanswered.

The first unanswered question was this: at what point would "selected" price rises, "prompted by changes in supply and demand," which the President would tolerate, become "across-the-board" increases which he would not?

The total quantitative effect of the new steel prices on prices paid by the consuming public will probably be trifling. The price increases so far announced, which range from about 3 to 5 percent, apply to less than half the output of steel. The increase for all steel products appears to average about 1 percent. The industry's output is in turn valued at 2½ percent of gross national product. A rise of less than 2 percent in a product that

itself accounts for less than 3 percent of GNP hardly constitutes a national crisis.

Yet such a price rise can be very important to the steel industry itself. There has been no net steel price increase since 1958, though there have been five increases in steel wages raising wage-costs some 50 cents an hour. The industry's dollar volume of net profits in 1962, at \$567 million, was the lowest in ten years. Its profit margin on the sales dollar was 4.1 percent, the lowest since 1945. In its return on net assets it ranked 40th among 41 manufacturing industries. The three largest companies slashed their dividends. Five companies reported net losses. Employment in the industry dropped 13,000 compared with 1961 and 103,000 compared with 1957.

## NO LEGAL BASIS

Yet the President declares that he is "interested in protecting the American public—and it is the American public which would suffer most from a general increase in steel prices." How can the American public benefit, in either security or employment, from a sick steel industry?

And what does the President mean when he warns the steel industry that a price rise would "aggravate their competitive position" and be against "their own enlightened self-interest"? Is he implying that he knows better how and where to set prices than do the people in the industry?

The most ominous assumption in Mr. Kennedy's statement and actions this year, as last, is that he has the legal and moral right to tell the steel industry, or any other, just when, where, and how to set its prices. The whole procedure is without sanction of law. It is government by whim, by personal displeasure, by vague threat of punitive action, a menace to the whole concept of the rule of law.

## FREE MARKETS DECIDE

It is also selective and discriminatory price-fixing, without the explicit general standards that legal price-fixing would have to set. The President postpones a trip to Florida to issue a statement on a 2 percent increase in the price of steel, but is silent on a 100 percent increase in the price of two New York morning newspapers. Government officials last year announced "guideposts" which indicated that prices should be frozen where they were but wages could rise about 3 percent a year. Then the government this year stepped in and settled the East Coast dock strike by ordering a wage rise that knocked down even its own guideposts.

This does not mean that overall legal price- and wage-fixing would be preferable. All government price- and wage-fixing tends to reduce, distort, unbalance,



and disrupt production. The whole attempt to set up price- or wage-fixing “guideposts” is economically nonsensical. The only solution to this infinitely complicated problem is free competition and free markets.

The President’s expressed reason for his concern about steel prices is to head off “another inflationary spiral.” But the real threat of inflation today comes from the policies of the Administration itself—from unparalleled spending and planned deficits. As long as the government keeps pumping more dollar purchasing power into the economy, prices and wages must rise. ❁

## The Web of Prices

May 6, 1963

After his talk to the nation’s editors on April 19, President Kennedy was asked about his attitude toward both price increases and wage increases in the steel industry. “Now I know,” he remarked in replying, “that there are important editorial interests in this country who really don’t feel that this is the President’s business.” He went on to contend that it was.

A little further clarification on this point would be useful. The President has as much right as any other citizen to say whether in his personal opinion a certain price is “too high” or a certain wage is “too low.” But he has no moral right to use his office to try to impose a particular wage increase or veto a particular price increase by vague threats of punitive action, especially when Congress has not given him the legal right. Nor is it wise for Congress and the President combined to try to fix particular prices or wages in a private industry.

No one knows precisely how many prices there are in the American economy. The OPA once moderately estimated the number at 9 million. This implies trillions of interrelations. Prices and wages are interconnected and interdependent, in a web of inconceivable intricacy. To change any one may be to affect a thousand.

### DISCOURAGING STEEL

What is the effect, for example, if the government, by intimidation or law, prevents a price increase in steel? The steel industry is already sick. Its dollar volume of net profits in 1962 was the lowest in ten years. Its profit margin of 4.1 cents on the sales dollar was the lowest in seventeen years. In its return on net assets it tied for last place among 41 manufacturing industries. Consolidated employment in the industry was down 11,000 compared with 1961, and 169,000 compared with 1957.

Yet it is precisely in this industry that a very small price increase (averaging about 1 percent) is followed by

front-page headlines and a special statement from the President. The effect of governmental pressure to hold down steel prices below the level to which market forces would bring them could only be to make the industry still less profitable, to reduce employment in it still further, to discourage new investment and expansion, to keep it smaller and sicker than it would otherwise be. (The U.S. share of world steel production declined from 46 percent in 1950 to 25 percent in 1961.)

It is an error to suppose that by holding down steel prices below the market level the President or government could hold down “the price level.” The general price “level” depends upon the amount of money and credit in circulation. If steel prices are held down arbitrarily, while the amount of dollar purchasing power is unchanged, the tendency must be for more of other things to be bought or for their prices to be pushed up.

### DUTY OF GOVERNMENT

It is often said that steel prices enter into many other prices, and that a price rise in steel will be “pyramided” by fixed percentage markups on finished goods. It is true that users of steel will try to “pass on” any price increase, but it does not follow that competition will allow them to. Again it is the total amount of money and credit that will determine the outcome.

What, then, *is* the function of the government, and the “business” of the President? It is to maintain freedom of competition, and to refrain from inflation.

But as regards competition, the Federal government has applied a flagrant double standard. It is constantly attacking the steel industry for “monopoly,” though there are more than 275 individual companies in the industry, and though the U.S. since 1959 has been a net importer of steel. Yet the single labor union covering the whole steel industry owes its immense monopolistic bargaining power to Federal law.

And so, far from refraining from inflation, Mr. Kennedy is *planning* a deficit for this fiscal year of about \$9 billion, and another deficit for fiscal 1964 of nearly \$12 billion, and is opposing any serious effort to reduce or eliminate these inflationary deficits, either by reducing expenditures or maintaining present taxes. ❁

## ‘Progressive’ Taxation

May 13, 1963

In my column from Stockholm of Oct. 29 last year, I referred to the findings of the Swedish Taxpayers’ Association in a study shortly to be published. This study is now available, and it throws considerable



light not only on Sweden's system but on "progressive" income taxation wherever it exists.

The Swedish system is somewhat more complicated than our own. After exemptions of only about \$400 for single persons and \$800 for a family (converting Swedish kronor at a rate of five to the dollar), individuals pay first a local proportional income tax averaging about 15 percent. Then they pay, on the rest of their income, national taxes ranging from 10 to 65 percent. Thus the marginal top rate not only can exceed 70 percent, but a person with a taxable income of only \$4,000 may pay about 40 percent. The top rates above 70 percent apply to incomes above \$30,000.

### SWEDISH EXPERIENCE

Here are some of the findings of the Swedish study: the basic national income-tax rate of 10 percent brings in about 70 percent of total national income-tax revenue. If the maximum national rate stopped at 25 percent, the tax would bring in 90 percent of its present revenue. If the maximum rate stopped at 45 percent, the government would receive 99 percent of its present revenue. In short, the rates between 45 and 65 percent bring in only 1 percent of total national income-tax revenue. Swedes earning less than \$6,000 a year pay 81 percent of all taxes; those with incomes above \$6,000 pay 19 percent.

(It is instructive to notice how closely some of these figures parallel our own experience. The basic 20 percent rate yields 85 percent of the entire revenue from our personal income tax. Our whole progression up to 91 percent yields only 15 percent. And all the progressive rates above 50 percent yield less than 1 percent of total revenues.)

When most people hear such figures their first assumption is that "the rich" must be evading taxes. The Swedish study admits there may be some tax evasion, but estimates that the ratio is about the same at all income levels. The popular overestimate of the share of the tax burden that can be laid on the rich by progressive taxation, it points out, is "due to very exaggerated ideas as to the number of persons involved and their relative share of the income of the community."

### DESTROYING INCENTIVE

The total number of income-tax payers in Sweden in 1960, for example, was 3,478,254. The number of taxpayers with incomes over \$20,000 was 4,350, or only one in 800, and their total income was only 1.6 percent of the total income reported. Even total confiscation of income in excess of \$10,000, the study points out, would not add even 2 percent to total revenues.

This brings the taxpayer association's study to the effect of these high taxes and harsh progressive rates on production and the creation of income. The study

does not attempt any quantitative estimate, but contents itself with pointing out that "the inducement to work longer hours or to invest money in more or less venture-some enterprises declines at the same rate as the earnings of the taxpayers are reduced by taxes."

The study does make, however, one interesting quantitative observation. Most Swedish taxes are levied for the purpose of redistributing income in the form of subsidies or social services, such as old-age pensions, free education, free school meals, free hospital care, etc. The study estimates that "if all redistributive measures were abolished, taxation would be reduced by about 65 percent." But as two-thirds of this "redistributive" tax money returns in effect to the identical groups that paid it, one may ask whether this enormous monetary merry-go-round pays off.

Perhaps the most serious harm done by progressive taxation is not merely that it reduces incentives, production, investment, and growth, but that, by fostering the illusion that "the rich" are paying the bill, it contributes to the enormous growth in government expenditure. ❁

## To Defend the Dollar

May 20, 1963

If the Kennedy Administration continues the economic policies it has pursued since it came to office, if it reduces taxes while increasing expenditures, if it runs deficits in the current and next fiscal year of \$9 billion to \$12 billion, if it continues to press for easy-money policies, and the Federal Reserve continues to accede to them, what will be the consequences for the dollar?

Let us see how far we have come even over the last four years. At the end of 1958 our gold stock amounted to \$20.6 billion. Net foreign short-term claims against this amounted to \$13.6 billion. Today, however, our gold stock has fallen to \$15.8 billion and net foreign short-term claims against it have risen to more than \$20 billion. In other words, potential foreign claims exist to draw out our entire gold stock and \$4 billion besides.

Our gold and creditor position continues to deteriorate. In 1958 the deficit in our national balance of payments was \$3.5 billion; in 1959, \$3.7 billion; in 1960, \$3.9 billion; in 1961, \$2.4 billion; in 1962, \$2.2 billion. Administration spokesmen continually refer to the diminished *rate* at which we went into debt in 1961 and 1962 as an "improvement" or "reduction" of our balance-of-payments deficit. But this is wholly unwarranted. It is as if a man who went into debt \$3,500 in 1958, \$3,700 more in 1959, and \$3,900 more in 1960 were to declare that his financial position was better

now because he had only gone further into debt by \$2,400 in 1961 and by \$2,200 in 1962. The simple truth would be that a debt of \$11,100 accumulated at the end of 1960 would have increased to \$15,700 at the end of 1962. This is the real analogy.

### IF WE CONTINUE

Moreover, even the *rate* of deficit accumulation is estimated to have increased again, in the first quarter of 1963, to \$3 billion annually. We have been able to postpone gold losses by currency swaps and other expedients. But all of these deal merely with symptoms. We cannot permanently halt the deficit in our balance of payments or staunch the gold loss until we put our house in order.

If we continue our present fiscal and monetary policies, we must continue to lose gold. It is impossible to say at what point the loss of gold would precipitate a run on the remaining gold supply. If such a run starts, our government will be tempted—or feel forced—to resort to one of four main expedients:

1. Borrow heavily from the International Monetary Fund.
2. Try to get through the fund a general devaluation of world currencies.
3. Devalue the dollar alone.
4. Suspend gold exports.

### AN AVOIDABLE CRISIS

Any one of these courses would be a blow to the prestige of the United States and to the prestige of the dollar. Other countries probably would not lend to us through IMF unless we agreed to put our house in order—to stop the deficits, stop increasing the money supply, allow interest rates to go up. But why wait until we are humiliatingly forced to do what it is in our interest to do now voluntarily?

Another general devaluation of world currencies would tremendously shock confidence. It would be a signal for renewed world inflation on a huge scale. Devaluation of the dollar alone—say say to \$70 an ounce for gold—would double prices of imports overnight, touch off a huge domestic inflation, and end the dollar as a key currency. Suspension of gold exports would put us on a pure paper basis. The dollar would plummet immediately in the foreign-exchange market. What happened to it eventually would depend on our monetary and budget policy from there on out.

Yet such a crisis is not inevitable. As John Exter of the First National City Bank of New York has pointed out, we might still end our balance-of-payments deficit overnight if we merely “turned off the faucet” of new money and credit and allowed interest rates to go up. All that is necessary is for the Administration to put its house in order and to abandon the specious idea that

budget deficits and easy money are either necessary or sufficient to create prosperity and full employment. ☸

## Capital-Gain Tax Reform

May 27, 1963

Instead of the Administration's proposals for tax cuts and tax “reforms,” many businessmen and congressmen are advocating the cuts without any reforms. This attitude seems shortsighted. In the face of a huge prospective deficit, we cannot afford a heavy general tax cut. Yet tax reforms—of the proper type—are today not merely possible but urgent.

The most important of these reforms would be the abolition of all tax rates above 50 percent. Such rates are *prima facie* confiscatory. Their yield is negligible. On the personal income tax it amounts to less than 1 percent of total Federal revenues. But these rates have a profound effect in discouraging new risk investment and in slowing down the growth of employment and real wages.

If this rate reform were made, it would make other essential changes easier. One of these is reform of the capital-gains tax, today one of the most harmful of all our taxes.

Capital gains are not income. They cannot prudently be treated as income. This has been repeatedly emphasized by economists. We need not repeat their arguments here. It is sufficient to point out that the very people who are most insistent that capital gains be taxed at income-tax rates refuse to treat capital-value changes as equivalent to income changes. If a man has a short-term net capital gain of \$1 million, they want to tax this at the same rate as added income. But if he has a net capital loss of \$1 million, they will not permit this to be deducted from his ordinary income, but only \$1,000 of it in any one year. On the part of the government this is a cynical heads-I-win-tails-you-lose tax.

### GAINS VS. INCOME

Nor is the situation much improved by the lower maximum rate of 25 percent on long-term capital gains. Again there is no equivalent deduction against income tax for net long-term capital losses.

In *Newsweek* of Jan. 14 I pointed out not only the injustices but the harmfulness of the present capital-gains tax in “locking in” capital, in penalizing investors for transferring investments into new ventures, in discouraging investment of risk capital, and in stunting economic growth. I suggested half a dozen different ways in which the tax could be reformed. Here I should like to elaborate on one of these:

Segregate capital gains and losses from ordinary income. Have these capital gains or losses reported on a separate return. Tax these segregated net capital gains either at nominal flat rates or at the same rates as ordinary income. If ordinary income-tax rates are used, allow a reduction of, say, 2 percentage points of the capital gain for every month that the capital asset has been held. Thus if the capital asset has been held only one month, 98 percent of the gain would be taxed. If the capital asset has been held 24 months, 52 percent of the gain would be taxed. If it has been held for 50 months or more, there would be no tax. Deductions of losses would be allowed against gains, with an indefinite carry-forward of losses until absorbed.

### TAPERING OFF

This would be similar to the tapering-off system used in Sweden. An individual would no longer be locked in with an investment indefinitely. After four years and two months, at least, he could sell or exchange it without tax penalty. In certain cases, for an investment held longer than six months, the tax might be steeper than today. But this could be avoided by the option of a shift to the present 25 percent maximum, and a tapering off each year to a 20, 15, 10, 5, and 0 percent flat rate respectively.

Some rate advantage might be gained from segregated capital-gain returns by a person whose income and short-term capital gains were about equal, but even this would seldom occur if the top income-tax rate were 50 percent. The great dispute about the "evasion" of income taxes through "turning income into capital gains" would practically disappear.

Such a system of taxing capital gains would be much less damaging to investment and growth than our present system. In Britain long-term capital gains are not taxed at all. In Sweden the tapering-off period is about the same as here proposed. ❁

## Shortsighted Taxes

June 3, 1963

Even present taxes do not raise enough revenues to cover present expenditures. The Administration is not planning to cut expenditures but to increase them. The proposal to cut taxes now, to bring a deficit of \$11 billion or more in fiscal 1964 and an indefinite series of deficits thereafter, is fiscally irresponsible.

It amounts to saying to the American people: "We are making you a present right now of a big fat tax cut.

But of course you will have to lend us the \$11 billion needed to make up the shortage."

Clearly this does not make sense. If we assume that the Federal government ever expects to repay its debts in an honest dollar, it will have to raise taxes again later, not only to the present revenue level, but much above it, in order to pay off next year's increase in debt.

The proposed tax cut is shortsighted for another reason. The plan is to make the main revenue cuts in the lower brackets—to reduce the basic 20 percent rate eventually to 14 percent, and to take nearly a million people off the tax rolls. Some day, given reasonable economy in government, such a change may be possible. But not with present levels of expenditure. Once such cuts are made, it will be politically impossible to restore present rates in anything less than a clear national crisis.

All this does not mean that important tax *reform* is not possible now. Suppose the proposal was for a tax reform that would keep revenues at approximately the present level, with expenditures cut to balance the budget at this level. What reforms would be most desirable?

Here are six. The first and third were discussed here last week.

1—Abolish all personal income-tax rates above 50 percent. Such rates are *prima facie* confiscatory. Their yield is negligible, amounting to less than 1 percent of total Federal revenues.

2—Keep the 20 percent basic income-tax rate, but abolish the first upward jump to 22 percent on taxable incomes between \$2,000 and \$4,000. Make this bracket subject to a tax of only 20 percent. These two reforms would reduce the number of tax-rate brackets from 24 to eight.

3—Segregate capital gains and losses from ordinary income. Have them reported on a separate return. Tax these segregated net capital gains either at the same rates as ordinary income, or at nominal flat rates. If ordinary income-tax rates are used, allow a reduction of, say, 2 percentage points of the capital gain for every month that the capital asset has been held. If flat rates are used for capital assets held longer than a year, make the maximum rate, say, 25 percent for assets held between one and two years. Taper this rate down to 20 percent for assets held over two years, 15 percent over three, 10 percent over four, and 5 percent over five years. Let such assets be sold or exchanged without tax penalty if held over six years. Allow deduction of losses against gains, with an indefinite carryover until they are absorbed.

4—Make the maximum Federal tax on estates 50 percent, instead of the present maximum of 77 percent. And instead of demanding full payment of the tax



within fifteen months after death, allow it to be paid, without interest or other penalty, in up to ten annual installments, with a maximum tax equal to 5 percent of the value of the estate in any one year.

5—Reduce the corporation income tax from 52 percent to 50 percent. Impose this only on undistributed income. Tax income paid out as dividends only 47 or 48 percent.

6—Repeal the new “investment credit,” but allow much faster depreciation write-offs, or a substantial write-off (say 35 percent) in the first year.

All these reforms have a common purpose: to simplify our tax system; to start reducing the number and extent of punitive discriminations; to mitigate double taxation, and reduce the excessive deterrents to initiative, effort, risk-taking, capital accumulation, saving, and investment.

Our present tax system is above all shortsighted. When it discourages individual effort, penalizes the transfer of investments, forces the sale or liquidation of family businesses, discourages new corporate replacement and investment, it not only slows down our economic growth, but reduces tax revenues themselves. ❁

## Fear of Free Markets

June 10, 1963

The rejection by the wheat farmers of the Administration's strict production control plan, in the national referendum of May 21, marked a turning point in the 30-year history of governmental crop controls and price supports in this country. For the first time the wheat growers turned down the offer of a higher price support at the cost of still more controls. For the first time they voted for less money in exchange for more freedom. For the first time they voted against Santa Claus. Under that benign white beard, he was beginning to look suspiciously like Big Brother.

When one considers the immediate monetary offer and the tremendous propaganda for it, the farmers' decision was astonishing. If they voted for the government's plan to control the wheat supply, they were promised a support price of \$2 a bushel. If they voted against it, they were told by the Department of Agriculture and by the President that they could not expect more than \$1 or \$1.10 a bushel. Urging them to vote Yes were all the propaganda resources of the Agriculture Department (with its 100,000 employees), and the chief farm organizations with the exception of the American Farm Bureau Federation. On the day before the election President Kennedy personally appealed for a Yes vote.

## DRACONIAN CONTROLS

What moved the farmers to turn all this down was the Draconian stringency of the controls they were asked to accept. They were not merely asked, as in the past, to withdraw a certain percentage of their acreage from wheat in order to be eligible for price supports. Every farmer would have been restricted to an exact maximum number of bushels, based on his “historic” production. He would have been subject to the tightest control of production and marketing ever seriously proposed in this country. The real issue, in the words of the Farm Bureau, was this: “Is government supply management going to be the future way of life for the American farmer? Who will manage your farm—you or the Federal government?”

Apparently, also the farmers did not take seriously the Department of Agriculture argument that they were choosing between \$2 wheat and \$1 wheat. The effective support prices under the certificate plan would have been a blend of two prices—\$2 for certificate wheat and \$1.30 for non-certificate wheat. Even if the growers disapproved the program, they knew that the Secretary of Agriculture, under existing law, would be required to support wheat for those staying within their acreage allotments at 50 percent of parity, or \$1.25. And finally, they were apparently confident that the Administration and Congress would have to come forward with another plan.

## SELL THE WHEAT BACK

The farm price support program has been a mess from the very beginning. The mess gets worse and more expensive year by year. It is often said that the crop restriction plan was defeated by the agricultural “revolution.” But this is at best a half-truth. The contrast most often cited now is that between the national average of 14.5 bushels of wheat per acre in 1947–49 and that of 25.1 bushels last year. But this result has been in large part brought about by the price support and acreage plans themselves. The farmers raised the average per acre yield (1) by taking their least productive acreage out of cultivation and (2) by pouring more fertilizer and labor into the remaining acres—a procedure that paid because of the support price itself.

The only solution to the farm problem is a return to the free market. This column suggested several years ago—and now renews the suggestion—that the government sell its surplus of more than a billion bushels of wheat back to the farmers themselves on a quota basis and below the average estimated cost of production—or say about 95 cents a bushel.

But this or any other extricating solution is now blocked by the folly of our government in renewing



the International Wheat Agreement last year. In practically every direction, in fact (e.g., sugar and coffee), the Administration has rejected the free market and plunges deeper into regimentation and controls. ☸

## Capital Gain vs. Income

June 17, 1963

The decision of the House Ways and Means Committee to tax long-term capital gains more leniently is a step in the right direction. But it once more raises the question whether there is any economic justification for a capital-gains tax at all.

Economists have long pointed out that capital gains are not income. Capital values are the *result* of income, the “capitalization” of income. Security values rise and fall with income (and dividend) fluctuations. Corporate income is already taxed twice. First, the whole amount is taxed directly (about 52 percent); then whatever part reaches the stockholders as dividends is taxed again at personal income-tax rates. Price changes cannot be regarded as income legitimately subject to income tax, since the physical asset itself is unchanged. A capital-gains tax on securities is not merely double taxation but triple taxation.

Since 1933 neither Congress nor the Treasury has honestly believed that capital gains are indistinguishable from other forms of income. Otherwise they would have allowed all capital losses to be deducted *in full* from other forms of income. How can they justify taxing even short-term gains at ordinary income-tax rates as long as they refuse to allow deduction of short-term losses in *full* not only against short-term gains but against all other forms of “income”? The allowance of a maximum deduction of \$1,000 a year of capital losses against income is a token pretense of two-sidedness in a cynical heads-I-win-tails-you-lose tax.

### A TRANSFER TAX

The “capital-gains” tax is a sort of haphazard capital levy. It is in reality a *transfer* tax. It penalizes anybody who transfers from an investment he considers less promising to one he considers more promising—or who is forced to raise cash. With these exceptions, the capital-gains tax is optional; the taxpayer can indefinitely postpone or avoid it *by not selling*. And when the penalty on selling is as heavy as it now is, he is better off not selling unless he is certain (which he can seldom be) that his eventual loss from holding an asset will be greater than his immediate loss from selling it.

The Ways and Means Committee has provisionally decided to make this tax a little less onerous and to encourage some investors to sell investments with which they are now “locked in.” While still taxing short-term capital gains (on assets held for less than six months) at ordinary income-tax rates, and while still taxing 50 percent of the capital gain on assets held between six months and three years (or at a maximum rate of 25 percent on the whole gain) the committee proposes taxing only 30 percent of the capital gain on assets held longer than three years.

### TAPERING OFF

But as long as the committee is willing to go this far, why not carry out the logic of the change? If it keeps its present dual method of approach, it could tax 50 percent of the capital gain on assets held one year more than six months, 40 percent of the gain on assets held two years more, 30 percent of the gain on assets held three years more, 20 percent of the gain on assets held four years more, 10 percent of the gain on assets held five years more, and put no tax on assets held longer than six and a half years. It could accompany this schedule with *maximum* tax rates, respectively, of 25, 20, 15, 10, 5, and 0 percent of the whole gain.

And if this seems too complicated it could always, like Great Britain and other countries, refrain from taxing long-term capital gains at all.

It is excessive and discriminatory income taxes, in fact, that create the so-called problem of capital gains. When the government levies confiscatory rates up to 91 percent on high incomes, a corporation must pay an executive whose top income gets into higher brackets up to \$10 more for every \$1 more he can retain in net income. This is prohibitive, so the corporation substitutes a stock-purchase option. Then the government frowns on this as an evasion and a “loophole” and resorts to complicated tax provisions to stop it. But if it levied a proportional income-tax rate to begin with, or at least halted at a top rate of 50 percent, the “stock-option problem” would hardly exist. ☸

## Who Provides Welfare?

June 24, 1963

Many “liberals” are showing signs of disillusion with the welfare state that they once so ardently espoused. One such is Irving Kristol, co-founder of *Encounter* magazine in London and now senior editor and vice president of Basic Books in New York. In the June issue

of *Harper's* he openly wonders whether the welfare state has now become obsolete.

His puzzlement is detailed and documented. "There is a real question as to whether the welfare state, as it is taking shape in America today, is not exhibiting delusions of omni-competence." Kristol finds that well-intended government regulating and spending agencies "soon achieve a life of their own, beyond all trial and error"; that "things are out of hand"; that bold new government programs soon come to be operated by "the job-hungry second-rate." He begins to wonder why public housing is "so hideously dreary," and he admits that he "can hardly pick up a newspaper these days without my anti-bureaucratic nerve being given a shock."

### MEDICARE

He is particularly effective in analyzing the illusions behind Medicare: "Any medical insurance program is going to cost the taxpayer money. The mute appeal of a state-run monopoly is the illusion that over a period of time, and in some undefined way, people may get more than they put either because the Federal government will magically 'close the gap' or because 'someone else' (the rich or the employers or whoever) will be called upon to make up the difference. This idea is appealing, but baseless. It is as appealing, and as baseless, as the notion that government money is something additional to the people's money, instead of being identical with it. It is as appealing, and as baseless, as the belief that the steeply progressive income tax significantly reduces the tax burden of the average citizen. . . .

"Public welfare outlays by Federal, state, and municipal governments have doubled since 1955, and now amount to more than \$40 billion a year."

Yet even after drawing up this powerful indictment of the welfare state, Irving Kristol does not suggest that we abandon it, but merely that we stop regarding it as the *sole* road to welfare: "The idea of a welfare state does not necessarily imply that the state should itself always dispense all welfare. Perhaps it would suffice for the state to establish a legal framework for a society in which individual welfare is recognized as a *social* responsibility without at the same time necessarily being a direct responsibility of the *state*."

### FREE ENTERPRISE

But Kristol apparently fails to see that what is essential and basic in such a legal framework was established long ago. It is the institution known as Free Enterprise, or Capitalism. It stresses, on the one hand, personal economic freedom, including freedom to choose one's occupation, freedom to start new ventures, and freedom of consumer choice. It stresses, on the other hand,

private property—i.e., the right of the individual to keep the fruits of his labor. These institutions of freedom and private property maximize productive incentives. And as each of us spends the monetary rewards for his efforts on the things that *he* considers most likely to promote his or his family's welfare, the free-enterprise system also tends to maximize welfare.

There is, of course, a certain area of collective needs—national defense, police and fire protection, sanitation, roads and streets—that must be paid for by coercive taxation. But this "public" sector is necessarily parasitic on the "private" or voluntary sector of the economy. The reason the "public sector" should be held to a minimum, the reason the burden of proof should be on every effort to extend it, is that the increased taxation that necessarily accompanies this extension reduces both productive incentives and the individual's freedom to decide how to spend his own earnings.

The wastes and absurdities in bureaucracy that "drive people mad" are not accidental. They are an inevitable product of the welfare state itself—"the great fiction," as Bastiat called it more than a century ago, "by which everybody tries to live at the expense of everybody else." ❁

## Taxes: The Long View

July 1, 1963

At the basis of our present Federal tax system lies the so-called principle of "progression"—the principle that taxes should be levied not in any uniform proportion, but more and more steeply with an increase in a man's income. Though our generation has come to accept this discriminatory principle, it is important to remember that it is still relatively new and still relatively rare. All local real-estate taxes (perhaps the oldest of existing taxes) are proportional. The man whose property is assessed at \$20,000 is taxed only twice as much as the man whose property is assessed at \$10,000—not three times as much or four times as much.

Nearly all city and state sales taxes are also proportional. There is, say, a flat 4 percent tax on a purchase of \$1,000 as on a purchase of only \$10. The proportional principle is applied even in most Federal taxes—import duties, corporation taxes (with only one extra "bracket"), and social-security taxes.

### KILLING INCENTIVE

The big exception is the personal income tax. We have all come to accept this progressive principle, in the

alleged interests of “social justice,” and we are only just beginning to notice that it is not a very effective device for increasing revenues. It has been calculated that a flat income tax of 23½ percent, with present exemptions, would bring in all the revenue now brought in by the whole scale of “progressive” levies from 20 up to 91 percent. It has also been shown that taxes at the basic 20 percent rate bring in 85 percent of the whole revenue from the present income tax, while all the surtaxes up to 91 percent bring in only 15 percent of that revenue. It has been shown also that all the personal income-tax rates above 50 percent bring in less than 1 percent of our total Federal revenue.

But the relative unproductiveness of these progressive rates is not their worst defect. Much more important is their effect in discouraging effort and retarding that economic growth which everyone is so eager to attain.

The government professes to wish to encourage everybody to add as much as possible to the wealth and income of the country. But when it finds people who are productive far beyond the average it puts increasing penalties upon them, till it gets to the point where from some people it seizes \$9 out of every extra \$10 they earn. It is not merely that this undermines the incentives of the most productive part of the population, but the funds taken by the higher-income-bracket rates are precisely the fund that would otherwise have been likely to go into investment—into the expansion of existing enterprises or the launching of new ones. In other words, into growth.

#### DANGERS OF A CUT

The system of progressive income-tax rates is so generally accepted that there is no hope that the system will be changed, or even open-mindedly reexamined, at this time. But if Congress resorts to the folly of reducing taxes without reducing expenditures, and turns an already certain deficit into a much greater one, perhaps it will at least make practically the entire reduction in the upper-bracket rates. It could reduce these, say, to a maximum of 50 percent, to leave the taxpayer as much incentive to earn an extra dollar as the government has. The loss of revenue would be at most negligible; there might even be an increase in revenues.

If, however, Congress cuts the basic 20 percent personal income-tax rate down to 14 or 15 percent, as the Administration has proposed doing, the loss of revenue will be massive. And what is perhaps most serious, it will be politically next to impossible to put the rates back again. Restoration of the high-bracket income-tax rates, on the other hand, should their reduction prove costly in revenues, would be politically easy.

Relief to the lower-income brackets could be more safely attained by keeping the basic 20 percent rate, but abolishing the first upward jump to 22 percent.

Progressive taxation, by fostering the *illusion* that “the rich” are paying the bill, has contributed as much as any factor to the enormous growth in government expenditure. ☸

## The Foreign-Aid Folly

July 8, 1963

Though the United States has already poured more than \$4 billion foreign aid into India, it is planning to pour in more, including nearly \$1 billion for a government-owned steel mill.

The Clay Committee Report declared that “the U.S. should not aid a foreign government in projects establishing government-owned industrial and commercial enterprises which compete with existing private endeavors.” But the Administration seems determined to go ahead. India’s Minister of Steel and Heavy Industry warns us that India will build the plant “with or without United States aid.”

American officials who want our taxpayers’ funds to pay for this socialistic project argue that India “is starved for steel.” But even if we grant this, why can’t India simply import the steel? Why can’t she buy it from us? Our own steel industry is working far below capacity. Our steel exports have declined. Why should we further tax Americans, including our own steel industry, to subsidize more foreign competition?

#### BUYING STEEL ABROAD

Would a subsidized government steel industry be good for India itself? It is doubtful. Writing in the Indian magazine *Swarajya*, the American economist Milton Friedman declares: “The Achilles heel of the Indian economy at the moment is the artificial and unrealistic exchange rate. . . . So long as the exchange rate is as far as it currently is from a realistic rate, foreign assistance will simply be poured down a bottomless well.” He adds: “India has become a protected economy in which items are produced domestically at a multiple of the cost at which they could be obtained from abroad.” India wants a subsidized steel mill largely because a new privately financed mill at Bokaro simply would not pay.

Aid for such a steel mill would be a direct American subsidy for foreign socialism. But it does not follow that our foreign-aid program would be desirable even if it abstained from such follies. The principal reform



needed in our foreign economic aid program is to abolish it.

Let us see what some of the beneficent results would be. The governments of the underdeveloped nations would want to continue their policies of government planning, socialism, wage-boosting, inflation, and “economic expansion.” They would let loose a propaganda barrage saying they had been betrayed, and if they could no longer get aid from us they would go to Russia. But it would soon occur to the more sober-minded among them—recalling Cuba, for instance—that this was not the most promising route to prosperity and freedom. A few of their statesmen would point out that some countries, like Canada and those of Western Europe, had done very well by attracting private American investments. So they would send officials here to consult with American corporations and investment bankers.

### INVESTMENT CLIMATE

The bankers would tell them that American investors would be interested only if a climate were created attractive to investment. Asked what would bring such a climate, they would suggest that the borrowing government balance its budget, stop inflating its currency, stop “land reforms” that destroy property rights, stop excessive taxation, stop discriminating against foreign investments, stop expropriation and nationalization—in brief, stop socialism and try free enterprise.

“But this is dictating our internal policies!” some of the underdeveloped diplomats would protest. “Not at all,” the private bankers would reply, “this is merely telling you the conditions likely to attract investors.”

And if these reforms were adopted, the governments of the backward countries would be amazed to find not only that private foreign capital was attracted, but that their private *domestic* capital, instead of fleeing abroad for safety, was being invested at home, and that rapid progress was beginning as the result of increased *domestic* confidence.

Most of the sponsors of government-to-government foreign aid, alas, are socialists at heart, and have still to learn that the secret of prosperity is free enterprise. ☸

## Keynesian Inflation

July 15, 1963

Four years ago the present writer published a book called *The Failure of the 'New Economies'*. It was an analysis of the fallacies in Lord Keynes's book *The General Theory of Employment, Interest, and Money*, which had been

published in 1936. That book had become not only the dominant influence on the kind of “economics” taught in the colleges and universities, but the dominant influence on the economic policies being pursued by most Western governments. The Keynesian doctrines have encouraged a constant race between increasing wage demands by the labor unions and monetary inflation in order to make ever-higher wage rates payable.

It is amazing how long it has taken for a reaction against these doctrines to gather force and to find adequate expression. After the appearance of Keynes's *General Theory* a score or more of brilliant attacks on his ideas appeared as articles or as chapters in books. I brought some of these together, in 1960, in a symposium, “The Critics of Keynesian Economics.” Among them was an article by W.H. Hutt, professor of commerce and dean of the Faculty of Commerce at the University of Cape Town, on “The Significance of Price Flexibility.” This had appeared in 1954.

### DEMOLISHES TO BUILD

Hutt had, in fact, been troubled by the Keynesian obfuscations for many years, and as early as 1939 had published his *Theory of Idle Resources*, which brilliantly dissected one of them. But the practical unanimity with which his academic colleagues embraced the Keynesian revelation, and ignored or waved aside his privately communicated criticisms, caused him to lose his own intellectual confidence and to delay or withhold any major publication.

Now at last he has published a full-length book, *Keynesianism—Retrospect and Prospect* (Regnery, \$7.50), which analyzes and demolishes not only the fallacies of Keynes himself but of the whole school of Keynesians and post-Keynesians. It is not merely destructive. Though, as Hutt himself puts it, “it sets out to restate some of the essentials of ‘orthodox’ or ‘classical’ economic teachings in a form . . . more appropriate for contemporary controversies,” it does much more than this. It throws new light on a score of unsettled economic problems. Hutt has made a major positive contribution. He has written, in fact, one of the most penetrating and important economic books of the last 25 years.

### AN ACT OF GOVERNMENT

There is not space here to discuss adequately his exposures of Keynesian errors and misconceptions or his contributions to positive understanding—his discussion of the nature of economic coordination through the price system, of the nature of money, of income and how it is “generated,” of the consumption fallacy, the multiplier fallacy, the acceleration fallacy, the capital-saturation fallacy, and of the validity of “Say's Law.”



Nor is there room to discuss his final chapter on the amusing attempts of the “Keynesians of the Right” to grope their way back to orthodoxy while still trying to cling to the obfuscating Keynesian concepts and vocabulary.

I have space only to call attention to Hutt’s brilliant and powerful chapter on the chief practical consequence of Keynesianism—the almost universal policy of inflation. Since the appearance of the *General Theory*, “there has been a sort of race between inflation and the unions. . . . What a deterioration since the pre-1914 era *Simply because no one ever doubted then that governments would honor convertibility obligations* there were no balance of payments difficulties, no hot money flights, no devaluation scares, no complaints of world liquidity shortage, no restraints on international settlements, no blocking of foreign balances, and no quantitative trade restrictions for payment-balancing purposes. World discoordination is the product of the continuous misdirection of expectations which the Keynesian technique necessitates. . . . [Yet] people *are* very slowly awaking to the truth that *inflation is an act of government, and that it is almost always (in these days) the consequence of calculated, even if reluctant action.*” ❁

## Doubts about the EEC

July 22, 1963

It seems only yesterday that everyone was hailing the Common Market as an epoch-making step toward world freedom of trade, and a great new force to which the rest of us would have to adjust. Our own government gave it moral and political support. We frowned on the efforts of Britain and other countries to form a countervailing Free Trade Area, and urged them to seek admission to the Common Market, or (as it is officially called) the European Economic Community. Finally, the U.S. decided that its own most important step in the field of foreign trade should be to negotiate reciprocal tariff reductions with the Common Market, and enacted a law specifically designed to do that.

Then came a series of blows, delivered chiefly by President de Gaulle. When Britain, after many misgivings, applied for admission to the Common Market, her application was peremptorily rejected. Our own efforts to get the Common Market to reduce its high tariffs against imports of our poultry met with failure.

The shock was not only to Britain and the U.S., but to the Common Market countries themselves. Suddenly they realized that in France’s (or at least de Gaulle’s) opinion, they were at best junior partners,

and that the Common Market was to be a union under French hegemony.

### RECONSIDERATION

These political shocks have led to reconsideration of the economic consequences of the Common Market. From a dispatch by Edwin L. Dale, Jr. in *The New York Times*, we learn that “Doubts about the economic impact and benefits of the Common Market are being expressed both inside and outside the community.”

Economic analysts in several countries, it seems, have been putting together figures designed to show that the Common Market has had very little, if anything, to do with the general economic performance of the six member countries. Among their conclusions are the following:

1—“Economic growth of the member countries—France, West Germany, Italy, Belgium, the Netherlands, and Luxembourg—has actually been slower since the Common Market began than before. It is not argued that the Common Market has held back growth, only that it has not affected growth much either way since coming into being on Jan. 1, 1958.”

2—“The rate of investment in new plant and equipment also appears to have been unaffected.”

3—“Trade among the member countries has grown rapidly, but no more rapidly than before the Common Market began to dismantle tariff barriers. Recently this trade has been growing more slowly.”

### TREATING ALL ALIKE

We need not take these new statistical studies as necessarily proving anything either way. There are always such a multitude of economic forces and factors at work that a net statistical change cannot safely be ascribed to any one of them. But it is time to ask whether the Common Market, looked at economically, was really such a good idea in the first place. Is it in fact a move toward greater freedom of world trade, or is it a move toward great protectionist blocs? It has tended to split Europe into two camps rather than unite it. If Britain were admitted, it would be at the cost of breaking up the “common market” long established as the British Commonwealth.

The Free Trade Area, which our government discouraged, was actually far more promising as a step toward freer world trade than the Common Market. For the “Outer Seven” agreed to lower tariffs vis-à-vis each other without necessarily imposing a high uniform tariff wall against non-members, as the Common Market requires.

But there is a policy far better than either of these, to which no serious attention is paid in the present world. It is the policy of each nation, without joining blocs or

calling endless world conferences, simply reducing its own tariffs to benefit its own consumers, and not discriminating against any nation but treating all alike. It is the policy most likely to bring freer world trade and greater prosperity, and the only policy compatible with world peace. ❁

## The Risk Takers

July 29, 1963

The politicians and planners in Washington are as sincerely eager to eliminate unemployment as anybody. But if they are really to solve the problem, they need to understand how jobs come into being, and who brings them into being. It is not merely some impersonal and automatic thing called “consumer purchasing power.” Jobs exist because employers provide them. And employers start new ventures, or expand old ones, only when they see a prospect of profit commensurate with the risks.

The interests of “Labor” and “Business” are not antagonistic. On the contrary, in the long run they are practically identical. Employees can have well-paying jobs and maximum employment only if employers and risk takers have adequate incentives. As President Kennedy once put it: “Our primary challenge is not how to divide the economic pie, but how to enlarge it.”

But maximum output and full employment are often blocked because politicians and planners have a grossly oversimplified idea of who constitutes “Business.” They think of “Business” as made up of a few giant corporations or the heads of such corporations. They lecture these imaginary few on their “social responsibilities” and duties. And when “Business” is hesitant they chide the businessmen for their lack of confidence and for their “neurotic search for unending reassurance.”

### 3 MILLION EMPLOYERS

The picture of business as consisting of or dominated by a few giant corporations is quite false. Let us look at the situation concerning corporations alone. In 1959 more than a million of them—1,074,120, to be exact—filed income-tax returns. True, there were giants among them. As many as 2,319 had assets of more than \$50 million each. But 590,000, or more than half, had assets of less than \$100,000 each.

In addition to these million corporations there were 949,000 active partnerships, and 9,142,000 businesses and farms under a sole proprietor! Nor were the contributions of these unincorporated enterprises negligible. Where corporations reported a net income of \$47

billion in 1959, unincorporated enterprises reported \$46 billion.

Nor do small businesses, whether incorporated or not, make a negligible contribution to employment. In 1959, there were, in fact, more than 3.3 million separate employers reporting under the Social Security Act. Of these, only 54,000 employed 100 or more persons each. More than 1.9 million employed only three or fewer each. About 3 million employed fewer than twenty persons each, yet these small firms provided more than a fourth of total employment in commerce and industry.

### NEED FOR CONFIDENCE

This is how American business is made up. It consists of literally millions of employers, literally millions of risk takers. Who are these millions of small risk takers? They are people who, having saved a little money, start a hot-dog stand or a roadside diner or a filling station; or open a bakery or a paperback-book store or a dress shop or a TV repair service; or install a new “laundry-mat” or a new bowling alley; or build a house in the suburbs for resale, or remodel a building for doctors, or develop a new shopping center. What they do, and how many of them do it, depends on the risk climate in which they operate.

These small risk takers have no automatic assurance of success. At the beginning of 1961, a fairly typical year, there were 4.7 million firms in operation; but during the year 398,000, or nearly one in every twelve, were discontinued. Fortunately the ranks were filled by 437,000 new businesses.

The extent to which these millions of small risk takers start new ventures and create new jobs depends on their estimate of the chances of making and keeping a profit compared with the risk of losing their whole capital.

These are the people the politicians and planners should keep in mind, and not only the heads of a few giant corporations, in order to recognize the need of maintaining a climate of “business confidence.” ❁

## No Help to the Dollar

August 5, 1963

The Administration’s proposal to tax foreign securities is unfortunate from every angle. It is a further abridgment of the economic liberties of American citizens. It is another roadblock to free markets. It is a clearly protectionist measure. It is a beggar-my-neighbor policy. It seeks to cure our balance-of-payment problems at

the cost not only of increasing such problems for other nations but of disrupting their economies.

There were so many leaks in the proposal, even before the President announced the Canadian exemptions, as to make it futile in accomplishing its intended purpose of “helping the balance of payments.” The attempts to plug these leaks would lead inevitably to exchange controls. The proposal to give the President discretionary powers to discriminate as among securities and countries would substitute uncertainty and administrative favoritism for a rule of law.

The tax would, of course, do nothing to cure the balance of payments. On the contrary, its mere proposal has undermined confidence in the dollar. And the irony is that all punitive measures of this kind would be entirely unnecessary if the Administration had the courage and understanding to take the proper measures.

### HURTING OUR CUSTOMERS

The proposal to impose a so-called “interest equalization tax” of 2.75 to 15 percent on foreign securities offered in the American market had all the earmarks of a panicky idea that no one had thought through. Immediately after the President’s message, stocks collapsed on the Canadian and Japanese markets. Within three days the President announced that “new” Canadian security issues would be exempt from the tax. The Canadians had meanwhile pointed out that while \$457 million in new Canadian issues were purchased by U.S. citizens last year, Canada still had a \$565 million deficit in her trade with the U.S.

In other words, Canada was buying from us more than she was selling to us—and our loans and investments made part of this excess buying possible. But this also applies to Japan, which also buys from us more than she sells to us, and also partly because of our loans to her. And this applies to still other countries.

When one contemplates all its loopholes and exemptions—all direct investment, all securities or loans of less than three years, loans of commercial banks, securities of “less developed” countries—it is hard to understand what compensation even the Administration expects from its disruptive proposal.

### INFLATION CONTINUES

And all such measures are quite unnecessary. The deficit in the balance of payments could be stopped *overnight* if the government would *halt the inflation*. It took a timid step in this direction when the Federal Reserve increased the discount rate from 3 percent to 3½ percent. But this move was too little, too late, and too isolated. In such a situation the raise should have been at least one full percentage point. It should not have been accompanied by assurances that long-term interest rates

were going to be kept down. It should not have been preceded and contradicted by the Federal Reserve’s inflationary policy of buying Federal securities and so increasing the paper money supply. (The Federal Reserve held \$31.7 billion of government securities on July 17, an increase of \$2.7 billion in twelve months. In the same period the money supply has increased about \$4 billion.)

In the same week that the Federal Reserve raised the discount rate, moreover, the world learned that our Federal budget deficit in the fiscal year ended June 30 was \$6.2 billion, with the prospect of a deficit twice as big in the new fiscal year. Yet on top of all this the Administration is recommending increased expenditures and has renewed its suggestion for a substantial tax cut.

It is continuing this policy of inflation, which is the basic cause of the dwindling confidence in the dollar, as the result of the quite false Keynesian idea that inflation is the cure for unemployment. Because it will not accept the only real cure, it is plunging deeper and deeper into dangerous and disruptive expedients. ☸

## Inflation Is the Cause

August 12, 1963

The Administration would be well advised if it dropped entirely its unfortunate proposal for a tax of up to 15 percent on foreign securities sold in this market. If it nonetheless persists, Congress should certainly not enact it in any form. It is already so riddled with exemptions that it has become “more holes than cloth,” but though this means that it could have at best a negligible effect in “saving dollars,” even if it worked the way the Administration expects, it does not mean that it cannot do great harm.

It is a misfortune that it was ever proposed. For it has convinced both Americans and foreigners that a dollar emergency must exist to make such an emergency measure necessary. And it has raised fears both at home and abroad that still more drastic controls will be resorted to if this one does not work—which few expect it to do.

### SOURCE OF STRENGTH

The President’s message asking for this control was, in fact, full of inconsistencies and contradictions. At the very moment when he was asking for a barrier to trade and to capital movements he announced: “This nation will continue to adhere to its historic advocacy of freer trade and capital movements.” And in the very message



in which he asked for a tax intended to discourage or inhibit further long-term foreign investment in order to protect our balance of payments, he was explaining how lucky it was that we had made precisely such foreign investments in the past:

“Our payments deficits, measured in terms of our loss of gold and the increase in our short-term liquid liabilities to foreigners, have consistently been equaled or exceeded by the growth of our long-term high-yielding foreign assets—assets which have been and will continue to be an increasing source of strength to our balance of payments. Today, Americans hold more than \$60 billion of private investments abroad, and dollar loans repayable to the U.S. Government total over \$11 billion. At the end of 1962, all of these assets exceeded our liabilities to foreigners by an estimated \$27 billion. And they have shown an increasing strength over the years: our total income from these sources in 1959 was \$3 billion; in 1962 it had risen to \$4.3 billion, and we expect further substantial increases in the coming years.”

What the President is proposing is that a prohibitive tax now be put on voluntary private foreign investments, likely to bring in such future dollar income in interest and dividends, in order that the government may continue to tax this money away and pour it into “underdeveloped” countries—from which it is highly unlikely that we will ever get a dividend or interest return.

### EXCHANGE CONTROLS?

The tax on foreign securities would not work; but the danger is that in trying to make it work the government would move deeper and deeper into exchange controls. We have already gone far. Under Republican and Democratic administrations, the government first made it a crime for Americans to buy or hold gold at home. Then to buy or hold it abroad. Then Americans traveling abroad were only allowed to bring in \$100 of duty-free goods. Now we are to tax foreign security purchases. Will the next step be to limit the amount of money our tourists and businessmen may spend abroad? (This has already been suggested by Senator Javits.)

The whole compartmentalized item-by-item approach to the balance of payments is fallacious. In his message the President had to confess, at the same time he was estimating that the \$100 limit on duty-free goods “achieved a saving” last year “of more than \$100 million,” that our “total tourist spending in foreign countries rose another 10 percent . . . to nearly \$2.5 billion.” And overlooked by the sponsors of the tax on

foreign investments is that these investments have made possible a large part of our export surplus.

We can solve the balance-of-payments problem only by dealing with its basic cause—our domestic inflation. If we were to halt this inflation—by stopping budget deficits and cheap money—we could cure the balance-of-payments deficit overnight. But this is the one course that the Administration will not take. ❁

## Double Taxation

August 19, 1963

In spite of the growing seriousness of the balance-of-payments problem, and an already ominous prospective budget deficit, the Administration is renewing its pressure for tax reduction. Its argument is that such a tax cut will stimulate the economy. This argument might have some validity if taxes were reduced on investors and on productive enterprises. But these are the very groups on which taxes are to be *increased*—on the ground that more revenues must be raised to compensate for those lost by reducing taxes on those who are already, proportionately, being taxed least.

Specifically, the Administration has recommended not only that stockholders no longer be permitted to exclude from their taxable income \$50 of the dividends they receive each year, but be disallowed the 4 percent credit they may now take on the rest. In June the House Ways and Means Committee tentatively rejected both recommendations. But now a compromise is being considered to increase the dividend exclusion to \$100 a person and disallow the 4 percent credit entirely.

### 52 PERCENT TO START

This is precisely the opposite of what ought to be done. There is no more justification for the exclusion of the first \$50 of dividend income from taxation than there would be for the exclusion (on top of existing exemptions and deductions) of the first \$50 of wages or any other form of income. This exclusion ought no longer to be allowed. But the 4 percent dividend credit is an entirely different matter. It is not only justifiable; it is a mere token mitigation of a flagrantly oppressive double taxation.

Suppose a married man is a one-tenth partner in a business that earns \$200,000. His share is \$20,000. Assuming for simplicity that this is his total net taxable income above exemptions, he pays income tax on this amount of \$5,280. Then he is through. He can keep the remaining \$14,720 for his family (at least before state and other taxes).



But suppose he owns, instead, 2 percent of the shares of a corporation that earns \$1 million. His share is again \$20,000. But the corporation must pay about 52 percent of this in income taxes, or \$10,290, before the taxpayer ever sees it. (This is no different in principle from a withholding tax paid at the source.) Suppose, now, the entire remaining \$9,710 is paid to him in dividends. Though he already has been taxed much more heavily than the man who received \$20,000 from a partnership, his taxes have only begun. His remaining \$9,710 is considered his taxable income to *start*. Out of it, on the same assumption that this is his full taxable income, he would pay on this (with his 4 percent credit but without a \$50 exclusion) a tax of \$2,023, leaving him only \$7,687—or just about half of what he would have had from a partnership. Disallowing the 4 percent credit would raise his tax to \$2,124, leaving him only \$7,586.

### IN BRITAIN AND CANADA

Thus investment in corporations (upon which we mainly depend for industrial employment) is already heavily penalized. Our tax system reflects the delusion that a corporation's income is something in addition to that of its individual stockholders. The tax on corporation income is, in fact, a tax on income of the individual stockholders. Other countries recognize this. Canada allows a 20 percent credit on dividends. The British levy two taxes on the net profits of corporations: a tax of 15 percent, and in addition an "income" tax of 38¾ percent, bringing the total to 53¾ percent. But when a shareholder receives dividends, he is credited with having *already paid* his "standard rate" (38¾ percent) of personal income tax on these dividends.

So in the interests of promoting investment and economic growth our income-tax credit on dividends should gradually be increased rather than diminished. To protect it against misunderstanding or demagogic attack, however, it might be changed in form. Instead of allowing the individual dividend receiver a tax credit, a differential tax might be placed on corporation income itself—say, for a start, a 52 percent tax on undistributed profits, but only a 50 percent tax on profits paid out as dividends. ❁

## Let the Dollar Drift?

August 26, 1963

The 290-page report of the Brookings Institution on "The United States Balance of Payments in 1968" can only tend further to undermine confidence in the dollar.

Its diagnosis of the disease is false. Its analysis of causes constantly puts the cart before the horse. Its forecasts are mere guesses. Its proposed remedies would aggravate the disease. If persisted in they would destroy the dollar as an international currency.

We cannot, unfortunately, dismiss this report as merely reflecting the opinions of a private institution, or even merely the opinions of its particular authors. For the institution was explicitly asked by Walter Heller, acting on behalf of the Council of Economic Advisers and the Treasury, to make this report. The American taxpayers paid for it. Though it is called an "independent" study, it comes to the same conclusions on leading economic problems as the Council of Economic Advisers, and often in the same phraseology. It is, in brief, a quasi-official document. That is why it is so disturbing.

### CRYSTAL GAZING

The report rests on basic misunderstandings. It predicts "substantial improvement in the U.S. balance of payments by 1968" and even suggests that "the basic deficit will be eliminated by 1968, and that there will be pressures toward a basic surplus." The truth is that everything depends on what the government does. If it were to stop the budget deficits, stop printing more money through the Federal Reserve, stop holding down interest rates, it could halt the balance-of-payments deficit *overnight*. What it will be doing five years from now nobody knows, and therefore nobody knows, what the balance of payments will be in 1968. But it doesn't take a year, a big staff, and 290 pages to find that out.

The report, like the reports of the Council of Economic Advisers, is based throughout on ultra-Keynesian assumptions. It talks as if solving the balance-of-payments problem were an *alternative* to achieving sound prosperity, growth, and long-run employment, instead of being, as it is, a necessary *means* of achieving these goals. It believes that it is huge government spending and cheap money that create jobs. The effect of excessive wage rates on increasing unemployment is never mentioned. On the contrary, the report suggests (in true Keynesian style) that any *reduction* in money wage rates *increases* unemployment—though it inconsistently recommends that a country with a balance-of-payments deficit might wisely prevent "the general level of its money wage rates from increasing as fast as output per man-hour."

### FOR WORLD INFLATION

The report's implied cure for our economic ills, in brief, is unrestrained inflation. Of course it never uses that phrase candidly. It recommends "expansionary fiscal policy" and "lowering of interest rates" (which is

Keynesian for budget deficits and monetary inflation), and deplors the “undesirable constraints” that balance-of-payment worries put on these policies. It says “the classical means of improving the balance of payments” are “deflationary measures” that “cut employment and real incomes.” It even pretends that efforts to improve the net balance of payments would require “very substantial declines in total production and income.”

So the report’s remedy for the dollar problem is not for our government to halt its inflation, but for everybody to embark on a world inflation so that nobody will run short of money. This, of course, is not said in these blunt words. We are to set up a new “international monetary system” which “must provide enough liquidity.” (“Liquidity” is Keynesianese for cash.) “Substantial amounts [of credit] should be obtainable automatically by deficit countries” (i.e., us). These countries must be given “enough time” to “restore equilibrium.” The report does not say what happens if they use the time and credit to continue their inflationary spree. The legal requirement for a 25 percent gold reserve is “irrational.” It “long ago ceased to serve any useful purpose” and “should be abolished.”

I have only one question. Is this report likely to restore international confidence in the dollar? ❀

## Sham Tax Cut

September 2, 1963

Neither the Treasury nor the House Ways and Means Committee that adopted its proposed tax cuts has any reason to feel proud of what it did.

Let us recall some elementary principles that everyone seems to want to forget. Taxes are imposed, not out of pure cussedness, but to raise revenues. Their function is to raise enough revenues to pay for the government’s expenditures. Taxes, in other words, are a purely *derivative* problem. The real problem is to cut expenditures. But nobody wants to face this. So everybody can be a cheap Santa Claus by voting for tax cuts while voting for more expenditures.

When taxes fall short of meeting expenditures, the tax cut is not real. Either visible taxes must be correspondingly *increased* in subsequent years (if there is any honest intention of ever having even a “cyclically” balanced budget or ever paying off any of the national debt), or the deficit must be paid for by the hidden tax of inflation, i.e., of higher prices and cheaper dollars. If inflation worked out evenly, it would be a proportional income tax and capital levy on rich and poor alike. It never works out evenly, but falls most heavily on those

least able to protect themselves. In brief, any tax cut that leaves a deficit is a deception and a sham.

### HUGE DEFICITS

On Aug. 13, Secretary Dillon predicted a deficit of \$9.1 billion for the current fiscal year 1964, compared with his estimate in January of \$11.9 billion. But he also forecast still another deficit of \$9.4 billion for fiscal 1965. The day after the Secretary announced these tremendous deficits, the Ways and Means Committee adopted tax cuts, starting in the election year that begins next January, that will amount when fully effective, according to Treasury estimates, to \$11.9 billion annually. How much of this cut was allowed for in Secretary Dillon’s estimates of the day before was not clear. In any case the Treasury, this far ahead, has persistently underestimated the deficit. For the fiscal year ended June 30 last, it originally estimated a surplus. There was actually a deficit of \$6.2 billion.

The same thing happened in the preceding fiscal year, which ended with a deficit of \$6.3 billion.

If a tax cut were justified at all with present spending programs, it would not be the kind of tax cut that the Treasury has recommended and the Ways and Means Committee adopted. There would be an argument for a tax cut that ended confiscatory rates, that made the scale of progression less steep, that mitigated the taxes that do most to discourage effort, production, and growth. Such reforms would make possible greater revenues in spite of lower rates.

### MASSIVE REVENUE LOSS

But the new tax bill does the opposite. For the present personal income tax scale ranging from 20 to 91 percent, it substitutes a scale ranging from 14 to 70 percent. The result is that the tax cut at the bottom of the scale amounts to 30 percent and at the upper end of the scale varies from about 15 to 23 percent. Moreover, owing to a new “minimum standard deduction” gimmick, 1.5 million taxpayers would be taken off the tax rolls entirely.

The result is that 1.5 million fewer people will give a hoot how high government spending goes. The loss of revenue will be massive. It will be politically almost impossible to put these people back on the rolls or to restore the 20 percent basic rate. If, as Congressman Bruce Alger of Texas proposed, there had been simply a flat tax cut of 20 percent all down the line, the political problem of restoration would not be so serious. If the top rates had been slashed to a maximum of 50 percent, there would have been a maximum revenue loss of \$1 billion in the first year and probably *increased* revenues in succeeding years because of the incentives that would have been restored. Instead, the penalization

of investment was made even steeper by the proposed termination of the 4 percent dividend credit.

True, the new tax bill has a few good features. But in the context of planned deficits of more than \$9 billion a year, its tax reductions are a fraud that will deceive only the shortsighted. ❁

## Exporting Inflation

September 9, 1963

One of the great economic puzzles of the last half dozen years is that, though we have been inflating our money-and-credit supply at a disquieting rate, this has not been correspondingly reflected in our price level. Since the end of 1957 our nominal "money supply" (currency outside of banks plus demand deposits) has risen from \$136 billion to \$150 billion, an increase of about 10 percent. If we include time deposits in the total, the increase has been from \$193.4 billion to \$254.4 billion, or 31 percent. The Federal Reserve System has engineered this inflation by increasing its purchases and holdings of U.S. Government securities from \$23,982,000,000 at the end of 1957 to \$32,237,000,000, an increase of \$8,255,000,000, or 34 percent.

Yet when we turn to the official price indexes, we find that consumer prices have risen only a little more than 9 percent since the end of 1957, and wholesale prices a bare 1½ percent. Those who measure inflation not by money-and-credit supply but by price levels have therefore argued that there has been no real inflation in the last six years and that the fears of it have been unfounded.

They are wrong. What has happened is that most of our inflation has been exported. Broadly speaking, we have paid the cost of it, and Western Europe and the rest of the world have had the advantage of it.

### EASY-MONEY FUTILE

Why and how has this happened? One apparently obvious answer is the \$36 billion or so that our government has given in foreign aid and military assistance since the end of 1957. But this is only an indirect cause. The direct reason is that we have not only inflated, but inflated faster than the rest of the world.

More than 200 years ago the British philosopher David Hume pointed out that if a country with a gold currency tried to increase its money supply by bank credit or by added paper money, even if convertible, the only effect, other things unchanged, would be to drive out an equal quantity of gold. Now since the end of 1957 the U.S. has lost a little more than \$7 billion gold

(which it is interesting to compare with the \$8 billion increase in the Federal Reserve's holdings of government securities). In addition, our short-term dollar liabilities held by foreigners have increased more than \$10 billion. In brief, our inflation has been futile. We have, without intending so, inflated mainly for the benefit of foreigners. We have increased our nominal money supply since the end of 1957 by \$14 billion. But foreigners now hold \$7 billion more in gold, and \$13 billion more in liquid dollar assets, or \$20 billion more. Our inflation has caused our cumulative balance-of-payments deficit of \$22 billion since the end of 1957.

### SYMPTOMS VS. CAUSE

All this seems to have escaped the attention not only of our government economists and monetary managers, but of almost our entire banking community. But at least one man, John Exter, vice president of the First National City Bank of New York, for the last two years has been trying to tell his banking colleagues, government economists, and all Keynesian expansionists that it is our easy-money policy that produces our balance-of-payments deficits; that these deficits are a drag on our economy; that our easy money has been in vain; that its economic consequences have been a massive movement of reserves to other countries from our own, where they increase foreign money supplies, not our own; stimulate foreign economies, not our own; employ foreign labor, not our own.

He has also been pointing out that our efforts to plug up specific channels of gold and dollar outflow—such as prohibiting Americans from holding gold, reducing the customs-free tourist allowance, tying our foreign aid to purchases in the United States, bringing or keeping military dependents home, taxing foreign investment are all futile, because they attack the symptoms of the disease and not its cause.

It is our inflation, created through budget deficits, easy money, and Federal Reserve money creation, that is the cause of our balance-of-payments problem. Until it is stopped, the dollar must continue to weaken. ❁

## History of a Law

September 16, 1963

When Congress, in the last week of August, under the threat of a nationwide railway strike, passed a law imposing compulsory arbitration, and when the President, on the afternoon of Aug. 28, signed the bill with the threatened strike less than six hours away, a few oldsters may have recalled another ominous day 47



years ago—Sept. 2, 1916 when Congress, under the threat of such a strike, passed the Adamson Act (giving the rail unions a basic eight hour day, with pro rata for overtime), while the union leaders sat in the gallery holding their stop watches over the lawmakers.

After the passage of the present compulsory arbitration law (by 90 to 2 in the Senate and 286 to 66 in the House) grave misgivings were expressed by many liberals. Would the precedent spread? How could it be prevented from spreading? What is the future of collective bargaining? What will happen to the freedom of workers and of management?

But, on the other hand, many asked, was not compulsory arbitration the only alternative to an “unthinkable” nationwide railroad strike? Hadn’t everything else been tried? Hadn’t four and a half years of bargaining proved fruitless?

#### FOUR YEARS TO NOWHERE

The answer to the last question is clearly Yes. On Nov. 2, 1959, the railroads, charging that union featherbedding rules were costing them \$600 million a year, proposed work rules changes. They got nowhere with the unions. Under the Railway Labor Act of 1926, a Presidential Railroad Commission was set up. It studied the work rules for thirteen months, and presented its report on Feb. 28, 1962. The railroads accepted the proposed settlement. The unions flatly rejected it.

Then the National Mediation Board offered to arbitrate. The railroads accepted the offer, but the unions refused. On July 17, 1962, the carriers served notice under the Railway Labor Act that the commission’s recommendations would be put into effect in 30 days. The unions filed suit challenging the railroads’ action, and successively lost in the Federal district court, the appeals court, and the Supreme Court. On April 2, 1963, the railroads served notice that in six days they would make effective the work-rules changes that the Supreme Court had affirmed their right to do.

The next day President Kennedy named Emergency Board No. 154 to recommend a settlement. On May 13 the board brought in a report accepting the philosophy of the Presidential commission, but making further concessions to the unions. The railroads accepted the recommendations; the unions rejected them. Later they rejected suggestions made by Secretary of Labor Wirtz, though the carriers accepted them.

#### 37-YEAR RECORD

The story goes much further back. The Railway Labor Act was passed in 1926, nine years even before the Wagner Act, to try to prevent nationwide railroad strikes by imposing procedures close to compulsory arbitration. But in order to prevent strikes from being

called the Presidential boards have nearly always decided heavily in the unions’ favor—leading, among other things, to the present fantastic featherbedding rules. In November 1941, a Presidential board awarded the operating unions a wage increase of 7½ percent, and the non-operating unions an average increase of 13½ percent. The awards were rejected by both groups. Thereupon President Roosevelt reconvened the board and ordered it to try again because of (unspecified) “new evidence.” The board took the hint, and obligingly revised its awards upward by about 10 percent. The new awards were accepted.

On April 25, 1946, the engineers and trainmen turned down an award of a Presidential board for a wage increase of 16 cents an hour. On May 22, President Truman proposed that the 16 cents an hour be hiked to 18½ cents. The unions still demurred, and struck on May 23. President Truman had seized the roads on May 17. He asked Congress for temporary authority to induct strikers into the army, to take out anti-strike injunctions, and to cancel strikers’ seniority rights.

Isn’t it about time we re-examined the Railway Labor Act? ❁

### ‘Balance of Payments’

September 23, 1963

It is unfortunate that even most of the professional economists who discuss our “balance-of-payments” problem seem never to have heard of, or have completely forgotten, what their predecessors of the eighteenth century wrote on the matter. In a famous essay “Of the Balance of Trade,” written about 25 years even before the appearance of Adam Smith’s *Wealth of Nations* in 1776, the British philosopher David Hume showed that in a world of free trade and metallic money the problem of an “adverse” balance of payments could hardly arise.

“There still prevails,” he wrote, “even in nations well acquainted with commerce, a strong jealousy with regard to the balance of trade, and a fear that all their gold and silver may be leaving them. This seems to me, almost in every case, a groundless apprehension; and I should as soon dread that all our springs and rivers should be exhausted, as that money should abandon a kingdom where there are people and industry.”

#### MONEY SEEKS A LEVEL

After showing that fears of this kind had proved unfounded, he went on to demonstrate why such fears were groundless. Suppose, he asked, that four-fifths of all the money in Britain were annihilated in one night. What would be the consequence?



Hume pointed out that there would be such a fall in prices, because of the scarcity of money, that Britain would be a wonderful market for foreigners to buy from and an impossible market to sell to. In very little time, therefore, Britain would get back the money it had lost. If, on the other hand, all the money in Britain were multiplied fivefold in a night, the contrary effect would follow. British labor and commodities would “rise to such an exorbitant height, that no neighboring nations could afford to buy from us; while their commodities, on the other hand, became comparatively so cheap that . . . they would be run in upon us, and our money would flow out.”

In a free market, in other words, and with a metallic currency, the precious metals will tend to distribute themselves among countries in proportion to goods so as to equalize prices (allowing for transportation costs) of goods in different countries. Money will seek its international level for much the same reasons as “all water, wherever it communicates, remains always at a level.”

#### HOW TO LOSE GOLD

Has all this been invalidated by the development of bank credit and paper money? On the contrary, though bank credit was then only in its infancy (1752), Hume correctly diagnosed its effects: “I scarcely know any method of sinking money below its level, but those institutions of banks, funds, and paper credit which are so much practiced in this kingdom. These render paper equivalent to money, circulate it throughout the whole state, make it supply the place of gold and silver, raise proportionably the price of labor and commodities, and by that means either banish a great part of those precious metals, or prevent their farther increase. What can be more shortsighted than our reasonings on this head? We fancy, because an individual would be much richer were his stock of money doubled, that the same good effect would follow were the money of everyone increased; not considering that this would raise as much the price of every commodity, and reduce every man in time to the same condition as before.”

In brief, Hume saw clearly what our monetary authorities have either failed to see or have seen only belatedly and inadequately—that the certain way for a country to *lose* gold is to inflate faster than other countries. This is the cause of our balance-of-payments problem.

But poor Hume, our “new” economists may reply, did not see that inflation can have a stimulative effect. He did see it, and he also saw through it: “Money when increasing, gives encouragement to industry, during the intervals between the increase of money and the rise of prices. A good effect of this nature may follow too from

paper credit; but it is dangerous to precipitate matters, at the risk of losing all by the failing of that credit, as must happen upon any violent shock in public affairs.” ❁

## Books for Americans

September 30, 1963

Strange are the ways of committees that select books. Take, for example, the first definitive list of books assembled for the White House Library as made public in mid-August. This was chosen under the leadership of James T. Babb, the librarian of Yale University. He had the assistance of what one report called “the best brains of the Library of Congress . . . and a host of distinguished scholars, librarians, publishers, and experts in many fields throughout the nation.” The authors had to be United States citizens except for creators of “a very few classics.” After more than a year of “agonizing” weighing and sifting, the selectors finally settled on 1,780 titles in almost 2,600 volumes.

What was the result? I will confine my comments to the 96 books on economics. The selection is haphazard so far as quality is concerned, and with a pronounced leaning to the left. One is glad to see in it John Bates Clark’s epoch-making work, *The Distribution of Wealth* (1890), and to find Irving Fisher represented by his admirable *Theory of Interest*. But after a handful of books, the puzzles begin.

#### SOME PUZZLES

Why, for example, is Frank Knight represented by *The Ethics of Competition* (a collection of miscellaneous essays brought together by former students), while by far his most important and original work, *Risk, Uncertainty and Profit*, is omitted? Why is F.W. Taussig represented by his specialized “*Tariff History of the United States*,” while his *Principles of Economics*, the most famous, lucid, and long-lived college textbook ever published in America, is unmentioned? Why are not such outstanding free-enterprise economists as Frank A. Fetter, Benjamin M. Anderson, H.J. Davenport, and T.N. Carver not represented by a single book? And why, finally, is the greatest contribution to economic theory in the present generation, Ludwig von Mises’s *Human Action*, simply left out?

There are plenty of anti-capitalist books on the list. Emerson P. Schmidt, chief economist of the United States Chamber of Commerce, has pointed out that books supporting the inflationist-controllist philosophy of the late Lord Keynes outnumber the Keynes opponents three to one. J.K. Galbraith, with his pro-bureaucratic tax-and-spend philosophy, is represented

by no fewer than three books. The list is loaded with many a dull, pedantic compilation, and some pure junk.

### AN INSPIRING STORY

But there are still greater puzzles. The American Booksellers Association, in collaboration with Robert Kennedy, the U.S. Information Agency, and the International White House Libraries Project, has assembled about 100 books to be presented to each of 100 heads of state. The declared purpose is "to help tell the story of the American way of life to the people of one hundred nations in all parts of the world."

Yet one looks in vain for a single book on the list that does tell the inspiring story of American industry and American enterprise. The compilers had as possible choices John Chamberlain's *The Enterprising Americans*, which tells this fascinating history in both human and technical terms, and H.F. Williamson's *Growth of the American Economy* and J.W. Oliver's *History of American Technology*.

Instead of complaining of bad choices, it is a much more grateful task to recommend good books that have not yet received the attention they deserve. I have been meaning for a number of weeks to write about two economics books that appeared earlier this year. The first is a primer, *Essentials of Economics* (Van Nostrand, \$4), by a Mexican author, the late Faustino Ballvé. It is an admirable introduction, brief, simple, authoritative, and lively. The second is *Economics of the Free Society*, by Wilhelm Röpke (Regnery, \$4.95), which, though it occasionally concedes too much to Keynesian theories for my taste, is on the whole, because of its humanity, erudition, penetration, and its felicitous and luminous exposition, the most satisfactory intermediate and medium length text available. ❁

## One World or Many?

October 7, 1963

VIENNA—In the seventeen years since 1946 I have made ten trips to Europe, and like other visitors I have been struck each time by the steady and often accelerative increase in prosperity. Each year Europe seems more like America; the people are better fed, better dressed, better housed, and above all better auto-mobiled. For example, in Austria, from which I am writing, the number of automobiles has increased ten times in the last ten years, and there is now one passenger vehicle for every fourteen people. Of course this growth has its bad side; and traffic jams in European cities, with their narrow winding streets, are often worse than in

the U.S. But this increasing prosperity has now become an old story.

In Germany, at Wiesbaden, I attended a "German-American conference" of which the host organization was the German Institute for the Study of Middle and East European Problems, and the guest organization, the Foundation for Foreign Affairs of Chicago, which had been host to the German group in Chicago a year and a half ago. Among the speakers from the United States were Gen. Frank L. Howley, formerly in command of the American sector in Berlin, Stefan Possony of Stanford University, and Strausz-Hupé of the Foreign Policy Research Institute at the University of Pennsylvania. There were also some representatives from half a dozen European countries. Because so much difference of opinion was expressed, even between nationals from the same country, it would be impossible to present a consensus; so I yield to the temptation to quote only an epigram from journalist Robert Ingram, who remarked that "Mr. Kennedy seems to fear nuclear bombs more in the hands of his friends [his European allies] than in the hands of his enemies."

### AUSTRIAN DILEMMA

From the end of the war, and until 1961, the Austrian economy showed almost the highest growth rate in Western Europe—an average of 12 percent a year from 1945 to 1961 and an average of 6 percent calculated from 1953 to 1961. For the last year and a half, however, the expansion has slowed down to a rate of only 2½ percent.

In fact Austria, which is heavily dependent on foreign trade (about a third of its entire production is exported), has arrived at a crossroads; either it must integrate its economy with that of the Common Market or it will be inescapably driven into the sphere of Soviet power and influence. Until now roughly half of Austria's exports have gone to the Common Market and more than 60 percent of her imports have come from there. Already 17.5 percent of Austrian exports go to the Communist bloc. Some Austrian economists (notably Prof. Franz Nemschak, head of a semiofficial research organization) point out that unless association can be achieved with the Common Market, Austria will be forced into more bilateral trade with the Communist bloc, increased governmental planning, loss of productivity, and eventually complete loss of political freedom and independence.

### FOREIGN ISSUES TAX

Most European bankers, businessmen, and economists with whom I have talked are appalled by our Administration's proposed "equalization" tax on sales of foreign securities in our market. Of course they are

concerned about the increased difficulty of meeting Europe's capital needs. But they also quite honestly think the proposed action self-defeating from our own point of view. The proposal, they say, has undermined confidence in the dollar. Before the President's proposal was made, an American underwriting group had almost finished arrangements for a \$20 million loan to Austria. Based on previous experience, Europe itself would have bought 60 to 80 percent of this loan. Negotiations, however, had to be suspended in favor of short-term bank credits. So this could mean a net outflow of \$20 million instead of only \$4 million to \$8 million.

But most of all Europeans are baffled by this move, on the part of the previous "banner-carrier" for free capital movements and international integration, back toward economic isolationism and restrictionism. ❁

## Farm Program Fiasco

October 14, 1963

Our crop price support program is now some 30 years old. Its evils have been cumulative—so much so, that the problem of extricating ourselves seems all but insoluble.

In the summer issue of *Modern Age*, a quarterly review, Karl Brandt, formerly one of the three members of the President's Council of Economic Advisers, and now director of the Food Research Institute at Stanford University, admitting the difficulty of auditing the full amount of the social and economic costs of the price-fixing policy, tries to list its "worst features":

1—"The gigantic amount—over 80 million tons—of excess grain stocks which represent a misinvestment of many billions of dollars, a physical bulk which must be transported, stored, and handled at enormous expense, equivalent . . . to two solid lines of freight trains from New York to San Francisco.

2—"A price level set high above equilibrium, which is continually menaced by the existence of the giant surplus stocks: grain 'in jail' is still grain.

3—"The effected socialization of the holding of stocks of the price-fixed commodities.

4—"The impossibility of returning to a non-manipulated free market provided only with disaster insurance so long as these huge government stocks exist without a solid official commitment that they will not be returned to commercial markets.

5—"The gradual attrition of one of the most refined market mechanisms of the capitalistic economy—the future trading in commodities.

6—"The capitalization of the value of the allotments in the land values, and the boosting of farm real-estate values by the price-fixing.

7—"The loss of commercial export sales that could be made at lower, more realistic export prices.

8—"The encouragement of price-fixing for farm products in the European Common Market, in Japan, and other importing countries.

9—"The serious weakening of the bargaining power of the United States in its efforts to free the flow of agricultural products in world trade over import barriers, export subsidies, and bilateralism."

All of these distortions, as Brandt points out, are merely by-products of the decision to protect the farmers' income from disastrous declines by fixing prices.

But how do we ever end the program? Brandt's own opinion is that "a sudden change of policy could put thousands of farmers through the wringer of foreclosure." His own remedy would be a gradual restoration of free markets, a gradual lowering of support prices to a market level at which crops would move freely. But first of all we would have to abolish the enormous excess stocks of grain. "The proper way would be to reduce them by conversion to meat over some six years, outside market demands, and by a gradual liquidation that writes them off at a loss." Not until these nuisance stocks are lifted from the market "can we disengage farm products from government buying and price-fixing." Meanwhile, Brandt thinks, there might have to be an aid program that would "undoubtedly cost several billion dollars a year for several years."

### SELL IT BACK

The trouble with such a "gradual" disengagement program is that as long as the government sets any support price at all above the level of a free market it will go on piling up still more surplus stocks.

I have several times suggested in this column that the government sell its surplus of more than a billion bushels of wheat back to the farmers themselves on a quota basis and below the average estimated cost production. A farmer could either pay for and take his quota, or order it sold on the market and receive a check for the difference. There would be some objections, I admit, to this course also. And even this solution is now blocked by our government's folly last year in renewing the International Wheat Agreement for another three years. This commits the U.S. to conduct all trade in wheat at a minimum price of \$1.62½ a bushel. The government has not only walled itself as regards wheat, but by its sugar import quotas and its involvement in an international coffee agreement it is driving deeper and deeper into a centrally directed economy. ❁



## World Monetary Reform

October 21, 1963

Representatives of ten leading industrial nations announced on Oct. 2 that they would start the first major negotiation and study of the world's monetary system since the Bretton Woods Conference twenty years ago.

The project suggests misgivings concerning the workings of the system set up at that time. But the prospect of reform in the direction of a sounder system is not bright. For the basic assumption of all governments today is that they have not only the right but the duty to tamper constantly with the national money. This is known as "monetary management."

The general lines along which the study and negotiations are likely to proceed are indicated in an article in the October issue of *Foreign Affairs* by Under Secretary of the Treasury Robert V. Roosa. This article may fairly be taken as reflecting present official U.S. policy.

Unfortunately Roosa begins by rejecting out of hand the only real solution—a return to a full international gold standard. He repeats the old charge that this was precisely the "system which broke down after World War I and led to the currency chaos of the '30s." The gold standard did not "break down." It was deliberately abandoned and destroyed by monetary "managers" who wanted to dilute and inflate their national currencies, and rightly recognized the gold standard as the great barrier to their plans. The reason governments are now implacably opposed to a return to the full gold standard is that it would deprive them of their present powers to "manage" and "expand"—in brief, to inflate.

### WORDS VS. REALITIES

Roosa, of course, puts this in more euphemistic words: "National policies for incomes, as well as for interest rates and credit availabilities, seem to be, or to be becoming, a normal part of the responsibilities which all governments now acknowledge in varying degrees for promoting growth, avoiding instability, and achieving external balance." Compare these words with today's realities. It is precisely these income and interest-rate "policies" that have retarded growth, *created* instability, and *destroyed* external balance. The dominant cause of the deficit in our balance of payments, and of our loss of gold, is our domestic inflation.

The monetary "reforms" that Roosa thinks will be considered all contemplate continuance of "the present gold-dollar-sterling-IMF system as the means of providing reserves," as well as enlargement of currency swaps and other "cooperative credit arrangements,"

enlarging the resources of the IMF and the drawing rights of its members, and even "endowing it with the capacity to create credit and the power to allocate such credit among members."

All such proposals are ways of continuing and increasing credit expansion and currency inflation.

### DEPRECIATION RECORD

In Roosa's whole article there is not a word about the dreadful record of world currencies under the IMF system. On the contrary, we are told that "the Bretton Woods system is nearing the end of its second decade, a decade of remarkable achievement." Remarkable indeed. The last two decades show the worst record of international inflation, depreciation, devaluation, and repudiation ever achieved in peacetime if not in war.

Let us skip over the devaluation of the British pound and scores of other currencies in 1949 and take the record of the last decade alone, as presented, say, in the July letter of the First National City Bank of New York. A table of 43 national currencies shows depreciation (in domestic purchasing power) in all of them over the 1952–62 decade, ranging from 1.3 percent *annually* for the U.S., to 2.9 percent for Britain, 3.5 percent for France, and 21.5, 25, and 35.2 percent *annually* for Brazil, Chile, and Bolivia respectively.

The only reason the system has "worked" until now is that the dollar, to which all the other currencies are tied, has been anchored to gold. But with the anchor itself in danger of drifting from its present gold base, the only "reform" the world's monetary managers have to suggest is to increase the facilities for U.S. and world inflation. ❁

## A Shortsighted Tariff

October 28, 1963

The mere proposal by the President on July 18 of a retroactive tax on American purchases of foreign securities has already done great harm. It has brought about paralysis in such investment, created world uncertainty, and undermined confidence in the dollar. If the Administration does not withdraw the proposal, Congress should reject it promptly.

The proposal has now received impressive criticism from many quarters, but the most thorough analysis I have seen was in the Congressional testimony on Aug. 21 on behalf of the Investment Bankers Association of America by Amyas Ames, its president, and by Andrew N. Overby, chairman of its foreign-investment committee and former Assistant Secretary of the Treasury



and deputy managing director of the International Monetary Fund. Let me summarize the chief points:

1—The proposed tax will adversely affect the U.S. balance of payments in the long run and will not significantly improve it in the short run.

Private foreign investment is an asset-creating expenditure. Current net capital outflows are offset by income from previous investments. From 1958 through 1962, income from all private foreign investment amounted to \$15.4 billion compared with an aggregate net outflow for new investment of \$16.6 billion. Moreover, in 1962 alone income amounted to \$3.8 billion as compared with a net outflow of \$3.3 billion.

Trade follows credit. With the dollars they obtain from U.S. purchases of their securities, foreigners buy our goods and services. Often the connection is direct. The Japanese Telephone Co. (KDD) raised \$25 million through sale of securities in this country to lay a 3,000-mile submarine telephone cable from Tokyo to Hawaii. All of the money raised is being spent in America making jobs for American workmen. Apart from such examples of direct connection, our foreign investments provide foreigners with the necessary dollars to purchase our exports. If other things remain unchanged, our exports will tend to be reduced by the same amount as we reduce our foreign investments.

2—The proposed law is not addressed to the fundamental causes of the balance-of-payments deficit. The great “leakage” comes from foreign aid and other government programs totaling \$4 billion in 1962 and overseas military expenditures reaching some \$3 billion. There is little hope of correcting our balance-of-payments deficit unless we reduce these expenditures substantially, improve our cost position in relation to our competitors abroad, and increase the attractiveness of foreign investment in the United States.

3—The proposed tax would be more accurately described not as a tax at all but rather as a new protective tariff to limit the importation of foreign securities. So viewed, the so-called “tax” represents a retreat from our long-standing policy of freedom for capital movements.

4—The United States capital market, and foreign economies dependent upon it, may be seriously damaged. The U.S. is now the only free capital market in which the amount and terms on which an issuer can sell its securities are limited only by the marketplace. This is a precious national asset. It should not be dissipated without convincing reasons of national interest.

5—The proposed tax may create fears of further restrictions. We must not impair the value of the dollar

as the key currency of the world. Diminished confidence in the dollar can only have an adverse impact on our balance of payments.

6—The proposed tax is discriminatory. It selects only one aspect of private expenditure abroad—private portfolio investment—for restriction through a special tariff while leaving unaffected private expenditures abroad for tourism, direct foreign investment, and commercial bank loans.

7—The proposed tax is administratively complex.

I have only one serious reservation to this admirable analysis. I wish it had recognized more clearly that the basic cause of our so-called balance-of-payments problem is our domestic inflation, reflected through our huge past and prospective budget deficits and our cheap-money policies. We are driving dollars and investment abroad as much by holding down long-term interest rates as by holding down short-term interest rates. ❁

## Undo the IMF System

November 11, 1963

Representatives of the governments of the ten most powerful industrial nations (outside the Communist bloc) have begun a study of the world's monetary systems. Such a study is long overdue. Yet the prospects that it will result in a real improvement are not bright. On the contrary, the most influential governments are pushing for an increase in world “reserves” and international “liquidity.” In plain English, they are pushing for more world inflation.

The real problem is how to bring this inflation to a halt. The real solution is to dismantle the International Monetary Fund system. This system has proved, in practice, a gigantic machine for world inflation. In the nearly twenty years of its existence, more and greater devaluations have occurred in national currencies than in any comparable period.

In *Newsweek* of Oct. 21, I called attention to this record, beginning with the scores of devaluations in 1949 touched off by the overnight devaluation of the British pound from \$4.03 to \$2.80. In the decade from the end of 1952 to the end of 1962, 43 leading currencies depreciated. The U.S. dollar showed a loss in internal purchasing power of 12 percent, the British pound of 25 percent, the French franc of 30 percent. The currencies of Argentina, Brazil, Chile, and Bolivia lost, respectively, 89, 91, 94, and 99 percent of their purchasing power.

## INFLATION BUILT IN

This result was not accidental. It was made possible, if not in effect caused, by the IMF system.

It is amazing that this system, jerrybuilt at Bretton Woods in 1944, is not only still tolerated, but regarded as practically sacrosanct. Its paternity was not auspicious. Its two fathers were Harry Dexter White of the U.S. and Lord Keynes of England. White, who later served as U.S. executive director of the IMF, was reported by the FBI in 1945 (as revealed in an announcement by Attorney General Brownell in 1953) to be a Russian spy.

Keynes urged Britain to adopt the plan precisely because he regarded it as inflationist. It would provide, he argued in the House of Lords (May 23, 1944), "a great addition to the world's stock of monetary reserves. . . . We are determined that, in future, the external value of sterling shall conform to its internal value as set by our own domestic policies, and not the other way round. . . . We intend to retain control of our domestic rate of interest, so that we can keep it as low as suits our purpose, without interference from the ebb and flow of international capital movements or flights of hot money." Finally, Keynes assured his hearers, "If I have any authority to pronounce on what is and what is not the essence of a gold standard, I should say that this plan is the exact opposite of it."

## TIED TO THE DOLLAR

If there were no IMF, governments whose currencies were shaky as a result of their reckless fiscal and monetary policies would be forced to go to private bankers or investors to extricate them, and private investors would insist on guarantees of fiscal and monetary discipline as a condition of such help. But Keynes insured that a nation's "domestic" inflationary policies "shall be immune from criticism by the Fund." He provided for automatic borrowing rights, and left any aid conditions to the necessarily *political* decisions of other governments through their representatives on the IMF.

Other countries have been able to devalue freely. But because all other currencies are anchored by the system to the American *dollar*, this freedom is denied to the United States, which cannot devalue without creating world monetary chaos. Our government has, nevertheless, continued to follow irresponsible fiscal, monetary, and interest-rate policies calculated to make this result inevitable. And this is what makes the IMF system dangerous for every other member nation. For the future value of their own currencies, and their own economic stability, have become dependent on the uncertain "domestic" fiscal and monetary policies of the United States.

Why not take another look at the possible virtues of a return to a world gold standard? ☸

## The Jobless, and Why

November 18, 1963

The Department of Labor has announced that unemployment in October amounted to 5.5 percent of the labor force. It has been above 5 percent since late 1957.

These figures puzzle Europeans, whose official unemployment estimates are much lower. When I was in Europe in September, I was repeatedly asked for an explanation. My answer ran something like this:

1—It's hard to tell whether the contrast is really as great as official estimates indicate. We count our unemployment differently from you. You usually count only the *registered* unemployed on the insurance rolls. We count in *addition* estimates based on a census sampling.

These additional unemployed are very generously estimated. Let me quote the Labor Department's own words (from its September monthly report): "The unemployed total from the household survey includes all jobless persons who were looking for work, regardless of whether or not they were eligible for unemployment insurance. Also counted as unemployed are persons waiting to be called back to jobs from which they had been laid off; those scheduled to start new wage or salary jobs within 30 days (except students); and those who would have been looking for work except that they were temporarily ill or believed no work was available in their line of work in the community."

Of course if we count as unemployed everybody who *says* he wants job, but is not even bothering to look for one, we can get a high total.

And the wider our inclusions in the "labor force" the higher our estimates of "unemployment."

2—The crucial question is how much of our statistical unemployment represents real economic distress. We get some light on this when we break the unemployed into categories. Then we find that (in September) the unemployment rate of males 16 to 19 years old was 14.7 percent, but that of males 25 to 34 years old was only 3.3 percent. For single men the unemployment rate was 10.5 percent, but for married men ("wife present") the rate was only 2.3 percent. Most unemployed youths are probably supported by their parents. Those who really need jobs most, tend to have them most.

We also get instructive results when we ask *how long* the unemployed have been unemployed. We find that 47.8 percent, or nearly half, have been unemployed less than five weeks. Only 25.2 percent have

been unemployed more than fifteen weeks, and only 14.3 percent more than 27 weeks (when unemployment insurance normally runs out). Stated another way, only 1.5 percent of the labor force are unemployed for more than fifteen weeks.

3—American legislation raises the unemployment rate. Our constantly rising legal minimum wage rate tends especially to cause unemployment among the lowest-paid workers. This is one reason why the jobless rate among colored workers averages 9.2 percent, compared with 4.2 percent among white workers.

4—Unemployment is also increased in the U.S. by high and long unemployment-insurance payments. We even subsidize strikes by unemployment insurance if the strike, say in New York, goes on for more than seven weeks. The extent of unemployment is not unrelated, also, to the size of relief payments.

5—Finally, of course, and perhaps most importantly, our Federal labor legislation is so drawn (and applied by the NLRB) that employers are almost impotent to resist excessive union demands. This encourages many unions to press demands that price a large percentage of their members out of the market, and even drive some employers out of business.

When I finished my answer, my European questioner would often ask: "But why don't the American authorities correct the situation?" I replied that the causes I had emphasized were almost never publicly mentioned. Unemployment in the U.S. is officially attributed to two factors: (1) "insufficient aggregate demand" and (2) "automation." Both explanations are fallacious; both lead to harmful policies. The "insufficient demand" theory causes pressure for constant deficit spending. And if automation throws people out of jobs on *net balance*, how can we explain why American *employment* this year is at the highest level on record? ❀

## Does Foreign Aid Aid?

November 25, 1963

It remained for Senator Morse, of all people, to blurt out the truth: "If foreign aid were submitted to a referendum of the American people, it would be overwhelmingly defeated." Certainly it would be defeated in its present prodigal and promiscuous form.

But whenever Congress grows restive and attempts to curb at least some of the more flagrant items in the program, the executive branch shouts that it is "threatening world security." President Kennedy even questions the good faith of opponents of the program. They "find it politically convenient," he says, "to denounce

foreign aid with one breath and the Communist menace with another."

This begs the whole question. *Has* foreign aid reduced the Communist menace (especially as compared with alternative programs)?

The military assistance program, in such places as Formosa and Vietnam, has prevented or slowed up direct Communism aggression or conquest. But has our *economic* aid, scattered over nearly a hundred countries, done anything appreciably to arrest the spread of Communism? The argument that it has done so rests on the assumption that all these countries live in "poverty and despair," and will turn in desperation to Communism unless their standard of living is substantially raised.

### POVERTY, OR IDEAS?

There is in fact no evidence that the Communist ideology increases in proportion to poverty. Hungary and Rumania, Poland and East Germany are Communist today not because they were poor but because they conquered. Cuba is Communist, not because it was any poorer than other Latin American lands, but because armed revolutionists seized power. Italy is more prosperous—and more people vote Communist—than at any time in the past.

In brief, if countries voluntarily go socialist or Communist, it is because of ideology, not because of their economic level. If people are led to believe that socialism or Communism is the quickest way to raise their economic condition, they will adopt it. If they recognize, however, that the surest way to improve their economic condition is by adopting the principles of capitalism and free enterprise, that is what they will do.

The Administration has ignored this. Czarist Russia chronically exported a surplus of grain; Communist Russia cannot even feed its own people. Yet instead of exploiting this fact, our government rushes to relieve the Communist plight. It does not point to the failure of Khrushchev's production boasts, because it accepted them. Lastly, Secretary Freeman was praising the "real progress" achieved by the Russians in the last five years in the production of grain.

### NO CORRELATION

Has foreign aid appreciably raised income and living standards in the recipient countries? In the last fifteen years, of course, living standards have improved in nearly *all* countries. But no correlation is detectable between the rate of growth in each country and the amount or percentage of American foreign aid. The President belittles its cost to us. It is only "seven-tenths of 1 percent of our gross national output." But then it



must be similarly minute percentage of the total GNP of the hundred or so nations among which it has been scattered. How, then, could it substantially increase their living levels? Especially as it is offered to Latin American countries on condition that they embark on “national planning” and “land reform”—i.e., on still more socialism and welfare-statism.

Has our foreign aid improved our own economic conditions? The President contends that it has. “A cut of \$1 billion in our total foreign-aid program may save \$100 million in our balance of payments—but it costs us \$900 million in exports.” He forgets that such “exports” are *given away*. They are paid for by *our own* taxpayers, who would otherwise have had the \$900 million to buy things for themselves. The \$100 billion total we have paid out in foreign aid set back our own capital development, our own economic growth, by \$100 billion.

If our foreign aid finally destroys the dollar as the world’s anchor currency, whom will it have helped? ❁

## The Vice Presidency

December 2, 1963

Though the assassination of President Kennedy came as an incredible shock, it did not bring the uncertainty and chaos that might have followed in a country under different institutions. The nation was not left in doubt for an hour concerning Mr. Kennedy’s successor. It knew almost immediately that it would be the Vice President, Lyndon Johnson. Yet the incident once more raises the question whether the constitutional and statutory arrangements for the succession to the Presidency, when the incumbent dies or is killed in office, are adequate or even reasonably satisfactory.

It is, of course, a gain for the orderly transition of power, and for the reduction of uncertainty, that the name of the successor should be known. But even the institution of a hereditary monarchy provides this kind of transition and certainty. What remains in doubt when a Vice President succeeds to the Presidency through the accident of death is not only what changes in policy he will attempt, but what support he will get from Congress, and whether he would in fact have been the choice of the country for President. The succession of Andrew Johnson following Lincoln’s assassination, and the bitter struggle with Congress that followed, culminating in the attempt to impeach him (which failed only by a single vote), dramatized all these doubts and misgivings.

## ABOLISH THE OFFICE?

No one expects a repetition of anything approaching this now that another President Johnson has been brought into office by an assassin’s bullet. Because of Lyndon Johnson’s long and brilliantly successful experience as Majority Leader of the Senate and because he represents more nearly the center of his own party, it is probable, indeed, that he will gain more cooperation from Congress than President Kennedy did, and may even succeed in reconciling the Northern and Southern wings of the Democratic Party. But if this turns out to be so, it will be a lucky accident and a result hardly attributable to our institutional provisions.

Should the U.S. Constitution be amended to abolish the office of Vice President? When there is a Vice President in office it is difficult to discuss this abstract institutional question without being suspected of a personal bias for or against the incumbent. But when, as now, the office falls vacant, it seems opportune to consider it with the seriousness it deserves. I should like to take the liberty of quoting from a book I wrote more than twenty years ago, *A New Constitution Now* (1942).

## CHOICE BY CONGRESS

“If the aim of a constitution is either to clarify the expression of the popular will or to bring the ablest men of a country into leadership, the institution of the Vice Presidency achieves neither purpose. On the contrary, the institution beclouds campaign issues. It forces many voters to choose a man they do not like in order to elect a man they do like. It would be an obvious improvement in our democratic machinery if only candidates for President were nominated and elected, and if the Constitution were amended to provide, following the precedent in a number of other countries, that in the event of the death of the President the successor to fill his unexpired term would be chosen by the House and Senate sitting as a single body. A President so chosen would be certain to be an outstanding man, who would receive the willing cooperation of Congress, and would represent the sentiment of the country at the time he came into office.

“Such a man could not fail to be a better choice, on the average, than a man who comes to the Presidency accidentally through the death of the President. Congress, in making its own choice of a successor, would be forced to act with the utmost seriousness and responsibility. Compare this with the irresponsible and frivolous attitude of a party nominating convention that chooses a Vice Presidential candidate to ‘balance the ticket’ with little real belief that he will ever become



President—and with even a doubt whether he will ever become Vice President. The superiority of the method of Congressional choice is beyond question.” ❁

## To Reduce Uncertainty

December 9, 1963

In a single hour the shocking assassination of President Kennedy altered the whole political and economic outlook for the United States. Only the immediate knowledge that Vice President Johnson would take office on the same day reduced the uncertainty and confusion that would otherwise have prevailed. The incident should serve to remind us once again, however, of how inadequate both our constitutional and statutory provisions are to meet the contingency of the death or disability of a President in office.

Suppose President Kennedy had survived his wound but been seriously incapacitated? This is precisely what happened when President Garfield was shot on July 2, 1881, and lived on for 80 days. President Wilson collapsed on Sept. 25, 1919, and was not able to attend a Cabinet meeting until the following April. President Eisenhower suffered his heart attack on Sept. 24, 1955, and was incapacitated for two months. Yet neither during nor after any of these occasions did Congress attempt to clarify or amend the constitutional provisions regarding “disability.”

### WHAT IS ‘INABILITY’?

The constitutional provision reads: Art. II, Sec. 1: “In case of the removal of the President from office, or of his death, resignation, or inability to discharge the powers and duties of the said office, the same shall devolve on the Vice President, and the Congress may by law provide for the case of removal, death, resignation, or inability, both of the President, and Vice President, declaring what officer shall then act as President, and such officer shall act accordingly until the disability be removed or a President shall be elected.”

But what is “inability” or “disability”? Who is to certify it if the President himself is unable or unwilling to do so? Who has the authority to say whether or when the disability has been removed?

The most satisfactory solution of this problem would probably be to empower Congress itself to make these decisions, if a President were unable or unwilling to do so, and to elect, if necessary, an Acting President to discharge the powers and duties of the office until Congress declared the President’s disability to be removed.

As such a change would itself require a constitutional amendment, Congress should in the same amendment provide for the contingency of a successor to the President when there is, as now, no Vice President in office. In place of the present somewhat makeshift Succession Act, adopted in 1947, it should provide that Congress itself, sitting as a single body, choose the new President to fill the unexpired term. The amendment could direct the Speaker of the House, in the event that Congress was not in session, to act as President pro tem and call a special joint session for the purpose.

### A NEEDLESS OFFICE

Finally, in such an amendment, Congress could abolish the needless office of Vice President, and provide, in the event of the President’s death, for the above procedure to choose his successor for the unexpired term.

Such an amendment would solve many problems at once. The new President so chosen would be certain to be a man of outstanding ability. He would have the confidence of the majority of Congress and would therefore be more likely to secure its cooperation than any other man.

If at the time of President Kennedy’s election there had been no Vice Presidential candidate, and Mr. Johnson had still been Senator Johnson and the Senate’s Majority Leader, it is altogether probable that he would still have been today the choice of Congress as President Kennedy’s successor. But Mr. Johnson’s position is in this respect unique. In no other case of a President’s death or assassination in office does it seem probable that his successor would have been the one chosen by Congress as the new President had he not been Vice President.

President Johnson, therefore, is in a unique position to ask for such a reform. We may not always be able to prevent some madman from killing a President in office, but we can and must prevent him from, in effect, selecting a new President for us. ❁

## Aid—Or Investment?

December 16, 1963

Some bewildering contradictions have developed in our foreign economic policy. The government wishes to continue to give away, for example, some \$4 billion a year in taxpayers’ money to aid foreign countries. It insists that this aid is having only a negligible adverse effect on our balance of payments. At the same time it is opposed to American citizens *investing* their own

money at their own risk in foreign countries. It contends that such investments are a serious threat to our balance of payments. So it has proposed an almost prohibitive tax on them.

The government's theory is fallacious and the facts are against it. In the long run the outflow of American capital to foreign countries is more than balanced by the inflow of income earned by that capital. From 1958 through 1962, income from all private foreign investment amounted to \$15.4 billion compared with an aggregate net outflow of new investment of \$16.6 billion. In 1962 alone income amounted to \$3.8 billion compared with a net outflow of \$3.3 billion.

In a message to Congress last summer, President Kennedy called attention to this. "Our payments deficits," he pointed out, "measured in terms of our loss of gold and the increase in our short-term liquid liabilities to foreigners, have consistently been equaled or exceeded by the growth of our long-term high-yielding foreign assets—assets which have been and will continue to be an increasing source of strength to our balance of payments."

### SHORTSIGHTED TAX

Isn't it shortsighted, then, to stop the further growth of these assets? Isn't it obvious that, regardless of any immediate result, the proposed tax must adversely affect our balance of payments in the long run?

It is clear from the very nature of the transaction that a large part of our exports are made possible by foreign investment. With the dollars they obtain from American purchases of their securities, foreigners buy our goods. Our exports must tend to be reduced by the same amount as we reduce our foreign investment.

But though the government objects to private foreign *investment*, for fear it will hurt our balance of payments, it insists upon continuing to *give away* some \$4 billion a year in foreign aid. And it argues that this will *not* substantially hurt our balance of payments. A cut of \$1 billion in our total foreign-aid program, government officials maintain, could save only \$100 million in our balance of payments, but would cost us \$900 million in exports.

It is hard to see just how the government could go about proving this statistically. But to the extent that it is true, why doesn't the same logic apply to our foreign investments? Why are *they* a threat to our balance of payments while foreign aid is *not*? Why wouldn't cutting off \$1 billion in foreign investments *also* cost us \$900 million in exports?

### LOANS CREATE EXPORTS

The truth is that it would. In the long run, in fact, cutting off \$1 billion in foreign investment must cost us, other things remaining unchanged, \$1 billion in exports. The real difference is that the exports made possible by foreign investment are real exports. Foreigners pay for them. The exports resulting from foreign aid are sham exports. *We pay* for them. Sound foreign investments build American economic strength. Foreign giveaway sets back our own capital development and economic growth.

The truth is the exact opposite of what our foreign economic policy assumes. Foreign investment creates exports and so creates jobs for Americans. It creates assets, and in future years must benefit our balance of payments through payments of interest, dividends, and return of capital.

Private foreign investment, also, really develops the countries into which it is put. For them it is wealth-creating and income-creating. It is, in fact, by far the quickest and most efficient means to their economic progress. And if a government, as in Argentina, is shortsighted enough to think it can seize past foreign investments in its country without killing off future investments, or even losing our foreign aid, it ought to be promptly taught the opposite. ☸

## Investment as Scapegoat

December 23, 1963

It was a sad day when the House Ways and Means Committee approved the Administration's proposed penalty tax on purchases by Americans of foreign securities. Such a tax is shortsighted and ill-conceived in every way. In the long run it will not help, but hurt, our balance of payments. In the long run it will reduce our own foreign-asset holdings. It will seriously damage our international capital market, and the foreign economies dependent on it. It will not increase, but further undermine, international faith in the integrity of the dollar.

Last week I pointed out here a glaring inconsistency in the Treasury's argument. It holds that foreign-aid *handouts* have only a negligible adverse effect on our balance of payments, but that private American foreign *investments* are a serious threat to our balance of payments. The truth is, if anything, the exact opposite. As President Kennedy, in his message to Congress of July 18 last, pointed out: "Our payments deficits . . . have

consistently been equaled or exceeded by the growth of our long-term high-yielding foreign assets—assets which have been and will continue to be an increasing source of strength to our balance of payments.”

The immediate adverse effect of foreign investments on our balance of payments is minor. They provide the funds with which foreigners buy our goods. They thereby increase our exports. And future receipts from these investments (in the form of interest, dividends, and return of capital) must benefit the balance of payments in future years.

### PROMOTE WORLD GROWTH

But in addition to increasing the asset-strength of the United States, private foreign investment (as contrasted with government giveaway) does most to promote the fastest economic growth in the rest of the world. For private foreign investment goes to the places that promise the safest and biggest returns. This means that such investment goes to the places where property is respected and least liable to seizure, nationalization, prohibitive taxation, or other forms of harassment. It means that such investment goes where it seems likely to earn the highest returns—which means where it will be most productive—which means where it will do most to raise living standards.

The proposed penalty tax on purchases of foreign securities violates basic legal as well as basic economic principles. In its retroactivity it ignores the constitutional prohibition of *ex post facto* laws. It is discriminatory. Not only does it select for penalty only one form of private expenditure or investment abroad, while exempting others, but it discriminates *by name* against 22 countries—which happen to be the countries that manage their affairs best and where investment is safest—in the hope of deflecting investment into countries that have so mismanaged their affairs as to frighten off investment (as in South America) or to get themselves a chronic balance-of-payments deficit (as in India).

### WHO IS TO BLAME?

What the tax proposal does, in effect, is to say: “*You*, you private investors, are causing our balance-of-payments deficit.” But the cause of that deficit is clearly the government’s own policies—not merely foreign aid, not merely huge and chronic budget deficits, but arbitrarily holding down interest rates, both short-term and long-term. When the government holds down long-term rates, it drives more American investment abroad and discourages foreign investment here. If the Federal Reserve stopped inflating, and allowed domestic interest rates

to be determined by market forces, there would automatically be less American investment abroad and more foreign investment here. But the government prefers to keep this market interference and try to offset its evil results with still another market interference—and so carry us still deeper into a centrally mismanaged economy.

As the late President Kennedy wrote in his letter to David Rockefeller of July 6, 1962: “Private foreign investment . . . should not be subject to restrictions. . . . Government must confine its restrictive influences to its own expenditures.” ❁

## Tax Cut Regardless?

December 30, 1963

So the stage is all set for a tax cut of \$11 billion in the calendar year 1964, and everyone seems delighted. No one in official circles any longer mentions the obsolete idea that the budget ought to be balanced. No one has so far indicated, in fact, that the deficit will be any less than the \$9.2 billion that Secretary Dillon estimated about two months ago for the 1964 fiscal year, or the \$9.2 billion that he estimated for the 1965 fiscal year.

So, at best, we are borrowing money to cut taxes. This does not look like a very farsighted operation. But the situation is graver than this. If the government proposed to finance its planned deficits by borrowing real savings, at least it would not be resorting to inflation. But the most vociferous proponents of a tax cut want it precisely because they do want it financed by inflation—i.e., through the creation of new money. And the Federal Reserve authorities have already begun to supply this inflation. The nation’s “money supply” in the official sense (demand deposits and currency outside banks) increased \$6 billion between October 1962 and October this year. In a broader sense (including time deposits) the money supply increased \$20.7 billion in that period, or 8.6 percent. This is an extraordinary increase for a single year. This, rather than the mere anticipation of a tax cut, has triggered the boom in the stock market and business.

### WHY IT IS A SHAM

If Federal expenditures are allowed to run \$9 billion beyond revenues, the difference must somehow be paid for. And if it is made up by inflation—i.e., by the government’s creating more money—this means that it is being paid for by a hidden tax, an iniquitous tax paid

through higher prices. A tax cut at the cost of a deficit is a fraud.

Apart from the question whether there should be a tax cut at all at this time (without an even greater cut in expenditures to balance the budget), the kind of tax cut now proposed is far from the most likely to increase incentives and promote growth. What is most necessary to this end is to reduce the near-confiscatory rates on the higher incomes, and penalization of effort and success. But the tax bill as it passed the House does the reverse. By establishing a minimum standard deduction, it frees 1.5 million taxpayers from all tax liability. This must tend to remove the interest of that many more people in prudent fiscal management by the government, and increase the pressure for benefits they do not directly pay for.

**TO RESTORE INCENTIVE**

The House version of the new tax bill would make our income-tax structure even more steeply graduated than it already is. The percentage of reduction in the aggregate tax liability of various income brackets (as pointed out in the illuminating testimony before the Senate Finance Committee by Roger A. Freeman of the Hoover Institute at Stanford University) would run like this:

Adjusted gross-income class	
Up to \$ 3,000	-38.3%
\$ 3,000 to 5,000	-26.2
5,000 to 10,000	-19.9
10,000 to 20,000	-16.4
20,000 to 50,000	-15.1
50,000 and over	-12.6
Overall	-18.8

But what is needed to increase what President Kennedy called “the financial incentives for personal effort, investment, and risk-taking” is, most of all, reduction of the near-confiscatory rates on the higher incomes. As Roger Freeman rightly declares: “Government should not hold a majority interest in anybody’s income, and the top rate of the personal income tax should not exceed 50 percent.” The vote of the Senate Finance Committee to give a few taxpayers in unusual situations (it is estimated it would affect only 14,000) the option of limiting their maximum tax rate on personal incomes to 50 percent, is a debatable step toward this goal; but it is at least an encouraging recognition that present confiscatory rates have been destroying effort and incentives without producing revenue. ⚙





1964



## Succession and Business

January 6, 1964

The shocking assassination of President Kennedy was followed by hours of panic on the markets of the world. The reminder once again that sudden death—whether through violence, accident, or natural causes—can come to a President in office, and the recognition that our statutory provisions for succession when there is no Vice President are unsatisfactory to many, and that the provisions for the event of “disability” are vague and inadequate, led to considerable discussion of possible remedies.

Because these have a vital bearing also on the question of maintaining business confidence, or at least minimizing business uncertainty, in the event of the recurrence of such a tragedy, I felt justified in discussing the problem in two successive columns (Dec. 2 and 9). I expected to drop the matter there. But to my astonishment more letters have poured into this office on these two columns than on any I have written in years. And at least half of these letters have been based on a misunderstanding of what I proposed. I can only assume that I failed to make myself clear, and that the misunderstanding of my correspondents is shared by others who did not write. So I should like to take up two of these proposals again.

### DISABILITY

The first concerns the problem of Presidential disability. The Constitution provides: “In case of the removal of the President from office, or of his death, resignation, or inability to discharge the powers and duties of the said office, the same shall devolve on the Vice President, and the Congress may by law provide for the case of removal, death, resignation, or inability, both of the President, and Vice President, declaring what officer shall then act as President, and such officer shall act accordingly until the disability be removed or a President shall be elected.”

The defect of this provision is that it neglects to define “inability” or “disability”; or to specify who is to certify it if the President himself is unable or unwilling to do so; or to declare who has the authority to say whether or when the disability has been removed. It would be highly embarrassing, at best, to put such decisions on the Vice President or the person next in statutory line of succession. I suggested that the most satisfactory solution of this problem would probably be to empower Congress itself to make these decisions, if a President were unable or unwilling to do so, and to appoint, in the absence of a Vice President, an Acting President to discharge the powers and duties of the office until Congress declared the President’s disability

to be removed. Such an amendment, it seems to me, would reflect the intention of the existing constitutional provision, but make explicit what is now obscure.

### NO INTERREGNUM

As such a change would itself require a constitutional amendment, I went on to suggest that Congress should in the same amendment provide for the contingency of a successor to the President when there is, as now, no Vice President in office. I proposed that such an amendment should provide that Congress itself, sitting as a single body, choose the new President to fill the unexpired term. It was this proposal that was so widely misunderstood. Many correspondents assumed that while Congress was voting the nation would be left without a head. They overlooked the next sentence, in which I suggested that “the amendment could direct the Speaker of the House . . . to act as *President pro tem*, etc.” Until Congress’s decision on a new President was reached, in brief (even though that would probably not take more than a few days), the Speaker would exercise full Presidential powers. There would be no interregnum.

On one point, however, my wording was clearly to blame. In an unwise effort at compression I referred to the bitter struggle between President Andrew Johnson and Congress as “culminating in the attempt to impeach him (which failed only by a single vote).” Many correspondents have written to point out, quite correctly, that Andrew Johnson was impeached by the House, and that it was his conviction by the Senate which failed only by a single vote. ❁

## Looking for Scapegoats

January 13, 1964

For 30 years, with minor intermissions, our government has been following a policy of monetary inflation. The cost of living has more than doubled. Since the end of 1939, the money supply (demand deposits and currency outside banks) has been more than quadrupled—from \$36 billion to \$152 billion.

Since the end of 1957, the government has been worrying about a “deficit” in the balance of payments. Measured from that date, this deficit has reached a total of nearly \$19 billion—an annual rate of more than \$3 billion.

During this period government policy has increased the active money supply from \$136 billion to \$152 billion, or nearly 12 percent. It has increased total money supply (including time deposits) from \$193 billion to \$261 billion, or 35 percent. During this period, also, it



has granted more than \$24 billion, or \$4 billion a year, in foreign aid. It has failed to cover this amount in its annual budgets, which have run a cumulative deficit in the period of more than \$30 billion, or some \$5 billion a year. And during this period, finally, our monetary authorities have by deliberate policy been holding down both short-term and long-term interest rates “to encourage employment and economic growth.”

### BLAMING CITIZENS

In brief, the deficit in the balance of payments about which the government professes to be so worried has been brought about by its own policies. It has been annually giving more money and goods away to foreign countries than the amount of this deficit. By inflating, it has raised prices and costs in this country and made us less competitive in foreign trade. By holding down interest rates, it has made it less attractive for foreigners to lend or invest their money here at the same time as it has encouraged Americans to invest their dollars abroad to get a comparatively better return.

But the government refuses to acknowledge that this has been the result of its own policies. So it is looking for scapegoats. It puts the blame on its own citizens. It blames American investors. It is demanding an almost prohibitive penalty tax on the purchase of foreign securities. Nothing could be more absurd, because American investors, unlike the government, are not giving their money away to foreigners. They are buying assets for it. They are earning a return on it. In fact, in the five years 1958 to 1962 the aggregate net outflow of \$16.6 billion for new foreign investment was offset by \$15.4 billion of income from previous investment. And in 1962 alone such income amounted to \$3.8 billion compared with a net outflow for new investments of \$3.3 billion.

### MERCANTILISM

If an American investor who buys foreign assets is “hurting our balance of payments,” isn’t an American tourist who buys consumer goods abroad hurting it still more? “Indeed he is,” replies the government, “and that is why we have reduced the duty-free tourist allowance to \$100.” But why doesn’t it also put a maximum limit on what each tourist can spend in travel, or even prohibit our citizens from traveling abroad at all? It is the logical next step. But what logic would there be in stopping even there? What about American purchases of German cars, of Japanese cameras, of Irish linen, of English tableware, of Scotch whisky, of French perfumes, of Brazilian coffee, of foreign anything? Why

not put a prohibitive tariff on all of these things, and solve our “balance-of-payments problem” once for all?

But, someone may say: “This is mercantilism. This is madness. It would be, moreover, completely futile, because our exports depend upon our imports. It is only through selling to us that foreigners can get the dollars to buy from us. If we cut down our imports we must in the long run cut down our exports by the same amount.” Precisely so. And in the same way we must cut down our exports by as much as we cut down our foreign investments.

The government’s proposed remedy is not only immediately harmful but in the long run futile. But it will not adopt the only solution, which is to halt its own inflation. ⚙

## A Tax-Cut Proposal

January 20, 1964

An \$11 billion tax cut is being proposed in the face of a combined deficit for the fiscal years 1964 and 1965 until now officially estimated at \$18.4 billion, and placed even by the new budget estimates at some \$15 billion. We are borrowing money to cut taxes. The proposed tax cut is a fraud. Unless we are willing to slash expenditures we simply cannot afford at this time a tax cut in the sense of a tax reduction that would reduce revenues.

But we can afford tax *reform*. We can and should cut tax *rates* wherever these rates are so high that they actually diminish revenues. It is enormously probable that this applies to all personal-income-tax rates above 50 percent. All these rates together bring in about \$1 billion, or less than 1 percent of our total annual Federal expenditures.

But if these rates were eliminated, and present tax progression stopped at 50 percent, the government would not lose this \$1 billion. On the contrary (though, of course, no exact estimate is possible) there would probably be an increase in revenues from this change even in the first full year, and a much greater increase in succeeding years.

### FOR A 50 PERCENT TOP

The reason is, of course, that taxpayers allowed to keep at least half of every additional dollar they earned (instead of only 47 cents or only 9 cents) would once more want to earn extra dollars that they now have no incentive to earn. Their production would increase. They would have not only a restored *incentive* to invest; they would have the funds to invest that are now siphoned

into nonproductive government expenditure. And these increased investments would mean increased jobs, more productive and hence higher-paying jobs, and an increased rate of economic growth. Our frequently deplored slow rate of growth is mainly owing to our tax system—our excessive penalties on high incomes, profits, and capital gains.

Any tax rate above 50 percent is *prima facie* confiscatory. To abolish the confiscatory rates is, of course, politically the hardest thing to do. Politically the easiest thing to do is to cut the lowest rates still further—say from 20 percent down to 14 percent. But this would mean a tremendous loss of revenue, which with existing expenditures the government could not afford.

What would be possible, however, with only slight loss of revenue, would be to abolish the jump from 20 to 22 percent in the rate on taxable incomes (for single persons) between \$2,000 and \$4,000. This would not only reduce the overall average rate on incomes in this bracket, but on all incomes in brackets above it.

### THE GREAT ILLUSION

There are now altogether 24 different tax rates in our graduated income tax. Halting the progression at 50 percent would wipe out fifteen of these discriminatory rates, reducing them to a total of nine. If, in addition, the new tax law were to abolish the 22 percent bracket (and extend the 20 percent bracket) in the first year, and then in the next six years abolish successively the 26, 30, 34, 38, 43 and 47 percent brackets, with the government meanwhile keeping expenditures under control, the country at the end of that time would be left with only two tax brackets—of 20 and 50 percent respectively. It could then decide whether it wanted to keep the higher penalty rate.

Perhaps the greatest harm done by the progressive income tax, particularly the existing steep graduation, has been to create the *illusion* that a rich minority of “fat cats” are paying the bill. That this is an illusion should be plain. The basic 20 percent rate brings in 87 percent of the entire revenue from the present income tax. It has been calculated, in fact, that a flat income tax of 23½ percent, with present exemptions, would bring in all the revenue now brought in by the whole scale of graduated levies from 20 up to 91 percent.

If there were a flat proportionate tax, each of us would realize that he, and not “the other fellow,” was paying his share of our huge Federal expenditures. Not until enough of us recognize this truth will there be any hope of holding those expenditures within reasonable bounds. ❁

## How to Cure Poverty

January 27, 1964

President Johnson has declared an “all-out war on human poverty.” It is a laudable aim. It has, in fact, been the aim of rulers, statesmen, economists, reformers, religious leaders—of every man of goodwill—from time immemorial. It is an aim shared by all free-enterprise economists since the time of Adam Smith and by all socialists and Communists since the time of Karl Marx. The problem does not concern the end but the means. What is the best way to abolish poverty?

Unfortunately the means Mr. Johnson recommends are dubious. He proposes more and bigger government-spending programs—“to build more homes and more schools and more libraries and more hospitals than any single session of Congress in the history of our republic,” and to “budget the most Federal support in history for education, for health, for retraining the unemployed, and for helping the economically and the physically handicapped.”

### NOT BY INFLATION

Whether it is possible to do all this and still cut the total of Federal spending may be reserved for later consideration. But even on the face of his own budget projections this program will involve a combined deficit in the current and next fiscal year of \$15 billion. This gap will probably be financed by inflation—i.e., by printing more money, by lowering the purchasing power of the dollar and so raising prices. This cannot help the poor. Regardless of the immediate result, the long-run result of inflation must be to distort the structure of production, and hence to slow down the rate of balanced economic growth. This cannot help the poor. For the government to borrow \$15 billion now to reduce taxes \$11 billion means that taxes must later be raised to a still higher level to pay off the new debt. This must discourage production and employment, and cannot help the poor.

The economic proposal by Mr. Johnson that would do most harm of all would be to impose a still higher legal penalty for overtime even than the present stiff penalty rate of 50 percent. This could only raise costs of production, lift prices, reduce sales and output, and hence reduce employment. It could not help the poor.

Mr. Johnson proposes to give Federal funds to “the chronically distressed areas of Appalachia,” to expand “area redevelopment,” to “distribute more food to the needy through a broader stamp program.” All these are merely new forms of the age-old proposal to take from the rich and give to the poor, to take from the more productive to give to the less productive. What

the reformers who back such proposals forget is that you cannot “redistribute” the fruits of production without drastically reducing production itself.

For this “redistribution” reduces incentives at both ends of the economic scale. As the productive have more of their income taxed away from them, they have less incentive to exert themselves to earn it. As the poor get increased handouts and subsidies, they too have less incentive to improve their condition through their own efforts. The problem of curing poverty is difficult and two-sided. It is to mitigate the penalties of misfortune and failure without undermining the incentives to effort and success.

### RESTORE INCENTIVES

The way to cure poverty is not through inflation, “share-the-wealth” schemes, and socialism, but by precisely the opposite policies—by the adoption of a system of private property, freer trade, free markets, and free enterprise. It was largely because we adopted this system more fully than any other country that we became the most productive and hence the richest nation on the face of the globe. Through this system more has been done to wipe out poverty in the last two centuries than in all previous history.

The way to combat the remaining pockets of poverty is to keep this system; to reduce government intervention instead of increasing it; to reduce government spending and punitive taxation—in brief, to increase the incentives to the initiative, effort, risk-taking, saving, and investment that increase employment, productivity, and real wages. ⚙

## Must We Push Up Costs?

February 3, 1964

In his State of the Union Message, President Johnson made a recommendation that, if adopted, could do immense harm. He proposed “legislation authorizing the creation of a tripartite industry committee to determine on an industry-by-industry basis as to where a higher penalty rate for overtime would increase job openings without unduly increasing “costs, and authorizing the establishment of such higher rates.”

Employers are already compelled by Federal law to pay a premium rate of 50 percent above the regular wage rate for all overtime in excess of 40 hours a week. This legal compulsion of course benefits specific workers under special conditions. But it is doubtful whether even stiffer penalty rates would help the whole body of workers, particularly when we consider them in their

role as consumers as well as workers. Compulsory overtime rates increase marginal labor costs of production. In one way or another this increase in costs must reduce both production and employment below what they otherwise would be.

A firm that is subject to stiff competition, especially foreign competition, will not be able to pass on its increased costs in higher prices for its product. It may therefore have to abandon the idea of increased production and overtime employment. If firms in a given industry do not have to fear foreign competition, they may be able to add most of their increased costs to their prices. But with higher prices, sales will fall off, and both output and employment will be reduced.

### ABILITY TO COMPETE

Oddly enough, President Johnson, when he is talking about a compulsory 35-hour week instead of a 40-hour week, recognizes this effect. In a paragraph preceding his overtime recommendation, he said: “I believe the enactment of a 35-hour week would sharply increase costs, would invite inflation, would impair our ability to compete and merely share instead of creating employment.”

What bothers Mr. Johnson is that some firms are employing workers overtime, instead of hiring additional workers, in *spite* of the 50 percent premium rate. He assumes that an even heavier overtime penalty would force the employment of more workers. But would it? It is a striking fact that, in November, when the seasonally adjusted rate of unemployment was 5.9 percent of the working force, 7.2 percent of all hours in manufacturing were overtime hours, paid for at premium rates. This seems to imply that industry could have employed the whole working force at regular hours. Why didn't it? Since managers always try to keep costs down, and would avoid a 50 percent penalty rate if they could, it seems probable that among the job seekers they did not find enough with the necessary competence or skill to be worth employing at regular rates.

### THE NEED OF PROFIT

Whatever the explanation, a still further increase in the legal overtime rate could only make the situation worse by increasing costs. Mr. Johnson's proposal is even more disturbing from a legal than from an economic point of view. It would be discriminatory as between industries. It would subject each industry to the arbitrary decision of a board on which the government members would cast the deciding vote.

The solution of the problem of unemployment lies in a different direction. As even J.M. Keynes wrote in 1932: “Unemployment, I must repeat, exists because



employers have been deprived of profit. The loss of profit may be due to all sorts of causes. But, short of going over to Communism, there is no possible means of curing unemployment except by restoring to employers a proper margin of profit."

How long will it take for the world to learn this? How long will it take for us to learn that profits and employment go hand in hand, go up and down together, and that the first is indispensable to the second? Thanks to the initiative of the American Economic Foundation there will be a Hall of Free Enterprise at the coming New York World's Fair devoted to teaching this lesson. It deserves the support not only of big- and little-business men, but of every worker. ☸

## Estimates vs. Reality

February 10, 1964

On paper, President Johnson's first budget has some merits which should be stated at the very beginning. It gives at least lip service to economy. And it estimates administrative budget expenditures in fiscal 1965 at \$97.9 billion, which is half a billion less than the 1964 estimate.

But how probable is it that these estimates will be realized? Here a score of doubts arise. The new obligational authority asked for by the President for 1965 is \$103.8 billion. This is \$1.2 billion higher than 1964, and a new high record.

How reliable, then, are the new budget estimates? Let us begin on the spending side. The estimated reduction of \$500 million compared with 1964 is achieved by an estimated reduction of \$1.3 billion in national defense and of \$1.1 billion in other expenditures. This is partly offset by an estimated increase of \$1 billion in expenditures for "space" and interest, and of \$900 million for the "attack on poverty."

Yet many of the estimated reductions in other expenditures are very doubtful. For example, farm subsidies are estimated at \$5.1 billion, down \$1.3 billion from 1964. But this reduction seems to rest merely on a pious hope. The estimate for new obligational authority for foreign aid is surprisingly low at \$2.4 billion (compared with \$2.5 billion in 1964). But the President adds: "The 1965 budget does not allow for sudden opportunities that sometimes present themselves in international economic affairs." By this he refers to opportunities "to provide any additional funds needed," for which he promises to send in special requests.

## A NEW HIGH RECORD?

Finally, a score of welfare programs are to be expanded, and the President adds a half dozen more "to attack poverty." It is unlikely that all these together will add less than \$1 billion to spending. In brief, it is highly improbable that total spending in 1965 will actually be less than in the current fiscal year. It is much more likely to hit a new high record. On the revenue side of the budget, we are asked to believe in a paradox. The budget assumes that taxes are being cut \$11 billion a year, fully effective in fiscal 1965. Yet estimates of receipts from personal income, corporate, and other taxes are all higher than in either 1963 or 1964. They are \$93 billion for 1965, up \$4.6 billion over 1964 and \$6.6 billion over 1963. The argument is that lower tax *rates* will create so much prosperity that they will actually increase tax *revenues*.

## RATES VS. REVENUES

To judge how plausible this argument is, let us look at it in detail. The greatest percentage cuts in tax rates are in the lowest incomes. For adjusted gross incomes of \$3,000 and under, the reduction in aggregate tax liability is 38.3 percent; for incomes from \$3,000 to \$5,000, 26.2 percent; for incomes from \$5,000 to \$10,000, 19.9 percent, etc. This means that for the new income-tax rate brackets to yield *as much* revenue as their corresponding old rate brackets, taxable incomes in the less-than-\$3,000 bracket would have to rise 60 percent; in the \$3,000 to \$5,000 bracket 35 percent; in the \$5,000 to \$10,000 bracket nearly 25 percent, etc. Of course as personal incomes increase they get into higher tax brackets. But even so, is the new revenue estimate plausible?

The probabilities are very high that spending in 1965 will be higher and revenues lower than guessed at in the budget, and that the deficit in 1965 will be much bigger than the \$4.9 billion estimate.

In view of the past record, this would not be surprising. For the fiscal year ended June 30 last, for example, President Kennedy originally forecast a surplus of \$463 million; there was a deficit of \$6.3 billion.

But even on its face, the new budget is fiscally irresponsible. It will be the 29th deficit in 35 years. It is unconvincing for Mr. Johnson to call it a "giant step toward the achievement of a balanced budget." It is larger than the majority of the preceding 28 deficits. And it is based on the fallacious theory that a big deficit is necessary and sufficient for full employment. The one result it does guarantee is inflation and a further loss of confidence in the dollar. ☸



## Investment No, Aid Yes?

February 17, 1964

The Jan. 27 issue of the *Investment Dealers' Digest* reprints a letter from Secretary Dillon under the following prefatory note:

"Concerned about the effects of the proposed Interest Equalization Tax on foreign securities, the editors of the *Digest* were especially impressed by an article on the subject which appeared Dec. 16 in *Newsweek*. Written by Henry Hazlitt . . . it seemed to sum up succinctly the negatives of the proposal. We wrote to Secretary of the Treasury Douglas Dillon for his comments on the legislation and on Mr. Hazlitt's article. The Secretary's Jan. 8 response is published below in full."

In his reply the Secretary begins with a concession: "It is true that in the long run the outflow of American capital to foreign countries is more than balanced by the inflow of income earned by that capital." But this is my main point.

The Secretary goes on to argue, however, that this does not meet the *immediate* problem in our balance of payments. This, he insists, can only be met by his proposed "temporary" tax on foreign securities. But if this immediate problem is so urgent, why do we continue to give away billions of dollars in foreign aid? The crucial difference between foreign investment and foreign aid is that, when we invest in foreign countries, we in the long run get our money back, with interest. But when we give away foreign aid we get no money back. Anyone who opposes foreign investment on the ground that it hurts our "balance of payments" should doubly oppose foreign aid.

### 'EXPORTS' GIVEN AWAY

Secretary Dillon contends that foreign aid is "increasing in the form of U.S. goods and services and hence has a limited adverse effect on our balance of payments. In fiscal 1963, 80 percent of the foreign assistance commitments by the Agency for International Development was tied directly to U.S. goods and services." This figure has been often used by the Treasury, but without detailed evidence. Congressman Thomas B. Curtis has complained that AID has put out this figure with "no working papers to establish it at all." And Dillon himself testified in the House hearing on Aug. 20 that only "about half" of foreign economic assistance in calendar 1962 was in the form of U.S. goods and services.

But suppose the 80 percent figure were correct. What would it prove? As Melchior Palyi and other economists have pointed out, "tied" exports for foreign aid generate no payments from abroad. Such "unrequited" exports cannot offset imports for which we have

to pay. It is misleading to include them, as we do, with commercial exports for which we get paid.

### WILL TAX BACKFIRE?

Secretary Dillon contends that we must levy this tax "only as a temporary measure to meet our problem pending more fundamental solutions," which, "however, require time." Yet no fundamental solutions have been adopted. Nor are they even being seriously considered.

The deficit in our balance of payments began in 1958. It has since averaged nearly \$3.5 billion a year. It is in the main the result of our own inflationary policies. Since 1957 we have piled up a cumulative budget deficit of \$40.5 billion. We are planning another \$5 billion deficit for 1965. Our government has also discouraged domestic investment and encouraged foreign investment by holding down interest rates. Yet as one of the "fundamental solutions" for the balance-of-payments problem Dillon astonishingly lists the \$11 billion tax cut, which can only make the problem worse by encouraging more inflation and more imports.

The proposed foreign-investment tax may well have exactly the opposite effect from what its sponsors desire. As Allan Sproul, former president of the Federal Reserve Bank of New York, declared in a lecture last November: "We need to avoid experimenting with direct controls, whatever they may be called, which in times of strain may be interpreted as a forerunner of stronger controls of capital outflow, or even of all dealings in foreign exchange, which in turn would heighten the danger of anticipatory withdrawals of foreign funds from our market." ❁

## Phony Tax Cut

February 24, 1964

By a vote of 77 to 21 the Senate has passed substantially the same tax-cut bill as that passed by the House in September. So the country is certain to have a new tax law, bad in almost every respect.

A tax cut of \$11 billion, accompanied by a sufficient slash in spending to ensure a balanced budget, would have been a genuine stimulus to long-run economic growth. But the present tax cut is a fraud on its face. It is enacted in a fiscal year when the Treasury already expects a deficit of \$10 billion, and looks forward to another deficit in the next year of \$5 billion. So we are borrowing to cut taxes.

The tax cut may turn out to be deceptive in a double sense. It is called a tax cut of more than \$11 billion. Yet in the face of this, the Treasury blandly estimates that tax revenues will be \$4.6 billion *greater* in fiscal 1965,

when the cut is fully effective, than in 1964, and \$6.6 billion greater than in fiscal 1963.

The theory is that the tax cut itself will make us so prosperous that even the revenues will increase. This would no doubt have been possible if the confiscatory and unproductive tax rates above 50 percent in the higher brackets had been cut down to that level. But the slash is mainly in the lower tax brackets. It reduces the aggregate tax liability by an average of 19 percent. It reduces the tax liability of persons in the lowest bracket by 38 percent.

### IMPLAUSIBLE ESTIMATE

It would take an average increase in taxable incomes of more than 20 percent to realize the Treasury's estimate of higher income-tax revenues. That is just not plausible. If it were achieved in dollar terms through inflation, government spending would increase correspondingly. The 1965 deficit may be nearer to \$10 billion than to \$5 billion.

There would have been some compensation if the tax cut had been accompanied by real tax reform—if the burdens on production had been lightened; if the punitive income-tax rates above 50 percent had been abolished; if the one-sided capital-gains tax and the double taxation of corporate dividends had been mitigated. Instead, by reducing the already lower rates much more percentagewise than the higher rates, the scale of graduation has been made even steeper. Even the mere token dividend credit of 4 percent (far lower than that of Canada or Great Britain) has been abolished. Though corporation tax rates have been reduced, the reduction is offset by advanced collections.

### SOAK THE RICH

Thus a shortsighted soak-the-rich and penalize-the-productive philosophy has prevailed, even though it will stunt our economic growth, and slow down the increase in capital accumulation and investment upon which a nation must depend for all improvement in economic conditions, for any increase in real wages, and for any permanent success in a war against poverty.

In so far as there is any theory behind the tax cut except how to win the coming election, it is an extreme and discredited Keynesianism. It is the theory that the way to increase prosperity and employment is to increase "consumer spending." If you cut taxes, so the theory goes, consumers will have more to spend, and business, selling more, will provide more jobs. What this overlooks is that our unemployment is the result of excessive wage rates and labor costs in some lines as

compared with productivity. So if wage demands go up as much as prices, the unemployment will remain.

When government expenditures are higher than revenues, the difference must somehow be paid for. If the deficit is met by selling bonds to savers, the government will absorb the investment funds that would normally be used by business. What the advocates of the tax cut are really depending on, therefore, is that the difference will be paid for by newly printed paper money. This will further raise prices, lower the purchasing power of the taxpayers' remaining money, reduce world confidence in the dollar, and increase the "balance of payments" crisis about which the Administration professes to be so concerned. ☸

## Inflation and Statism

March 2, 1964

From time to time I have contended in this column that there is no need for a Council of Economic Advisers, and no excuse for an annual Economic Report. I wrote on Jan. 28, 1952, for instance, that the report "consists mainly of giving 'scientific' and 'economic' reasons for what the President has done or wants to do for political reasons. . . . [It] is Administration propaganda paid for by the taxpayers."

This year's Economic Report is just one more example. It is an out-and out campaign document. We learn from it that the Eisenhower Administration just couldn't do anything right. For instance: "Federal outlays leveled off early in 1957 and then declined, just at a time when expansionary policy was needed to avoid a downturn." Then, again, between 1958 and 1960: "Federal policy was restrictive and wholly inappropriate to a period of insufficient demand." And so on.

### CAMPAIGN DOCUMENT

All the comparisons in President Johnson's own eighteen-page economic report (summarizing the council's 283-page report) boast of the progress since "early 1961"—i.e., since the Kennedy-Johnson Administration came in. "Our record \$100 billion expansion since early 1961 has carried us past important milestones in the march toward a better life. . . . In the nearly three years of unbroken expansion since early 1961: GNP is up 16 percent, measured in constant dollars," etc. And remember: "An expansion as long, strong, and free of excesses as the one we are now experiencing does not 'just happen'. . . . *Government* has steadily pursued fiscal and monetary policies designed to promote recovery, accelerate expansion, and encourage business and consumer

confidence: in 1961, when the Administration's quick anti-recession program got recovery off to a flying start," etc.

I shall not here attempt to check back on the validity of the comparisons that the Economic Report makes with conditions in the Eisenhower Administration. I shall merely mention one comparison that it does not cite: in the eight Eisenhower years, unemployment averaged 4.9 percent; in the three Kennedy-Johnson years, it has been 6.0 percent.

Yet the new Economic Report concedes that, "by all odds, the country's No. 1 economic problem is persistent unemployment." How does the Administration propose to solve this? It proposes to solve it by the method that has persistently failed in the past—more monetary inflation.

### TAX CUT AS PANACEA

Its great reliance is on the \$11 billion tax cut. "Speedy passage of the tax cut . . . will provide a net fiscal stimulus, taking both expenditures and tax cut into account, that will be *three times as great* in 1964 as in any of the years 1961, 1962, and 1963—will, in fact, provide a greater net stimulus to the economy in 1964—to jobs, production, income, and profits—*than in any other peacetime year in history*. . . . The tax cut will give a sustained lift, year-in and year-out, to the American economy. When fully effective in 1965, it will send well over \$11 billion annually coursing through the arteries of the private economy."

It is clear that this \$11 billion is to consist entirely of deficit spending—that it is to be created by issuing \$11 billion of new money and credit. To make this quite plain, Mr. Johnson says: "It would be self-defeating to cancel the stimulus of tax reduction by tightening money."

Not once does the report suggest that any part of our unemployment may be caused by wage rates or labor costs already above marginal productivity levels, or that any adjustment may be needed. Instead it proposes remedies—e.g., "*higher overtime penalty* [wage] rates"—calculated to make the unemployment worse.

The remedies that the Economic Report prescribes for all our economic ills, in brief, are more deficits, more inflation, more controls, more statism. Not once does it dawn on the authors of the report that the government has *caused* our chronic unemployment, *caused* the balance-of-payments deficit, and *caused* our slow rate of economic growth, by precisely the nostrums it is advocating as a sure cure for these maladies. ❀

## Tax-Cut Fallacies

March 9, 1964

The Administration's pressure for the \$11.5 billion tax cut just enacted may be cynically ascribed to an effort to win the coming election. But it is also supported by an economic theory, a theory now widely and sincerely held, that is set forth in some detail in the recent Economic Report of the Council of Economic Advisers.

It is a pure "demand" theory. It assumes that, whenever there is recession or unemployment, the reason must be "insufficient demand." "Excessive unemployment is the most obvious symptom and one of the worst consequences of a level of demand that falls short of the nation's potential output."

Therefore, the report concludes, "the Federal government must adjust its programs to complement private demand. . . . The budget must counterbalance private demand." "Inadequate" private demand "can be corrected either by expanding government purchases to employ idle resources . . . or by expanding private business and personal after-tax incomes through reduced tax rates." In other words, the government can deliberately resort to deficits.

But this last word is still unpopular. It arouses distrust, so the council shies away from it. Instead, it invents a new concept—"the full-employment budget." This is a purely hypothetical budget, with no relation to the real one. It is what the relation of government expenditures and revenues *ought to have been*, according to the council's theory, to bring about full employment (or rather, to prevent unemployment from going above 4 percent).

### DREAM-WORLD SURPLUS

Let's see some of the consequences of this new concept. We have had 28 actual deficits in the last 34 years. But when we start talking of "full-employment budgets" most of these turn out to be "surpluses." In the fourth quarter of 1963 the Treasury was estimating the actual *deficit* at a rate of \$9 billion a year, but it turns out from the new calculations of the Council of Economic Advisers that at the time there was a "full-employment" *surplus* of \$9 billion. In fact, by this new method of hypothetical figuring there couldn't be a deficit in the "full-employment budget," no matter what the actual figures showed, as long as there was any unemployment!

The fallacies in this theory should be clear. It is a stale Keynesianism. It takes it for granted that any "idle resources" or unemployment anywhere must be the result of "deficiency of aggregate demand." By "demand" it means, of course, monetary demand. So this demand is to be increased either by more government spending



or lower taxes, and the bigger deficit is to be paid for by printing more money—i.e., by inflation. “When aggregate demand is generally deficient and investment and consumption are expanding too slowly to provide jobs for all those seeking employment, expansionary monetary policy normally can and should accompany expansionary fiscal policy.”

### DEMAND AND PRICE

Nowhere does the council recognize that “demand” is merely relative to price. When goods are priced too high some of them must remain unsold. When labor is priced too high some of it must remain unemployed. Unemployment is the result of maladjustment of wages and prices. Given wage-price coordination, supply creates its own demand.

The only way to cure unemployment is to permit, through free-market competition, the necessary adjustments and coordinations throughout the wage-price system, and to encourage saving, investment, and profits. As Keynes himself conceded in 1932: “There is no possible means of curing unemployment except by restoring to employers a proper margin of profit.”

Given workable wage-price relationships, full employment is possible without deficits and without inflation. But even huge deficits and inflation cannot bring full employment if wage rates are encouraged to rise faster than prices and productivity.

To cut taxes and increase our inflationary deficit may give us an overheated economy till election time, but it is a reckless and ominous policy for the longer future. ☸

## The Missing \$11 Billion

March 16, 1964

The House passed the \$11.5 billion tax cut by the overwhelming vote of 326 to 83, and the Senate by 74 to 19. The President hailed the cut as “the single most important step that we have taken to strengthen our economy since World War II. . . . It will immediately increase the income of millions of our citizens,” he continued, “by reducing the amount of taxes that you must pay. . . . By releasing millions of dollars into the private economy it will encourage the growth and prosperity of this land that we love. . . .”

But if it’s as easy as all that, a question that may occur to some is: why did we stop at an \$11.5 billion cut? Why not omit taxes altogether?

But let’s confine our attention to the situation as the government presents it. It estimates that in the

“administrative” budget there will be a combined deficit in the current fiscal year and in 1965 of \$15 billion, and that in the “consolidated” budget (reflecting the entire receipts from and payments to the public) there will be a combined deficit for the two fiscal years of \$11.2 billion. In other words, for these two fiscal years combined, the government will take in from the public a total of \$234.2 billion, but in the same period it will *spend* a total of \$245.4 billion, or \$11.2 billion *more*.

### FROM WHERE?

Where do the people who are so jubilant about the tax cut imagine that this \$11.2 billion is going to come from?

As the government won’t get it from taxes, there are only two other ways in which it can get it. First, it can sell bonds to the public that the public can pay for out of its real savings. But to the extent that it does this: (1) There will be no increase in “purchasing power,” because the people that buy the bonds will lose that amount of purchasing power for other things, just as if they had turned it over in taxes. (2) If the government takes \$11 billion out of the funds available for investment, either private business will be able to borrow just that much less for its own expansion and investment, or everybody will have to offer higher interest rates to tempt more lending and investment.

But the net effect of this might be deflationary. And the President has declared: “It would be self-defeating to cancel the stimulus of tax reduction by tightening money.” We must conclude, then, that the government intends to get the missing \$11 billion by, in effect, *printing* it.

### WILL IT BE PRINTED?

The process is indirect. The government sells its I.O.U.’s—bonds, certificates, notes, bills—to the *banks*. The banks “pay” for these by creating deposit credits on their books against which the government can draw checks. The people to whom it makes payments—defense contractors, veterans, farmers, or its own military or civilian employees—then transfer these credits to their own accounts or ask for cash, and the required amount of new (Federal Reserve note) cash is printed.

But how can printing more paper money increase production and employment? It may do so temporarily wherever wage rates have been too high to permit workable profit margins or where labor costs have forced prices higher than the existing supply of monetary purchasing power can support. In either case, however, a readjustment of price-wage relationships could restore full employment just as well. And if labor costs are allowed to rise as fast as or even faster than prices,



even with the new money, unemployment will continue nonetheless.

So if the \$11 billion gap between revenues and expenditures is met out of new money, that money will raise prices. Americans will pay a hidden \$11 billion tax through a lower purchasing power of their dollars.

It is a dangerous game for the government to play. The prospect of continued deficits will undermine world confidence in the dollar. If we try to keep interest rates down by an easy-money policy (with the Bank of England discount rate now raised to 5 percent) still more dollars may flow abroad and cause a further drain on our gold supply. We cannot “strengthen our economy” by weakening the dollar. ❁

## Shortsighted Tax

March 23, 1964

On March 5, the House passed by 238 to 142 the Administration's bill imposing a tax on the purchase of foreign stocks and bonds by Americans. It was a sad day for freedom of international investment. From the standpoint of the long-run national interest, it would be hard to imagine a more shortsighted measure.

The bill was passed ostensibly as a cure for the “deficit”—the net outflow of our dollars and gold—in our international balance of payments. Since the end of 1957, this deficit has been running at an average rate in excess of \$3 billion a year, and has reached a total of more than \$18 billion.

The cause of it has been our government's own policies. For 30 years, with minor intermissions, we have been following a policy of inflation. The cost of living has more than doubled. Since the end of 1939 the supply of dollars has been more than quadrupled. Since the end of 1957 our active money supply has been increased 14 percent. When we count time deposits, our money supply since the end of 1957 has been increased nearly 40 percent. During this period our government has granted more than \$24 billion, or \$4 billion a year, in foreign aid. We have run a cumulative deficit in the last six fiscal years of nearly \$38 billion, or some \$6.5 billion a year.

### BLAMING SOMEONE ELSE

On top of all this our monetary authorities have deliberately been holding down both short-term and long-term interest rates. This has been done “to encourage employment and economic growth,” but its effect is to discourage foreigners from investing here and to encourage Americans to invest abroad.

But under no condition will the Administration admit that the deficit in our balance of payments is the result of its own policies. It is determined to blame something or someone else. So it has decided to blame foreign investment and to penalize Americans for buying foreign securities.

Its decision to pick on the purchase of foreign securities as the scapegoat is purely arbitrary. If foreign lending and investment must be the villain, why not tax or forbid short-term bank loans abroad, or direct investments in new plants? Out of scores of major items in the international balance sheet that cause a net outflow of funds the most obvious is foreign aid, which has been running at some \$4 billion a year compared with the total annual payments deficit of only \$3 billion. The next most likely candidates are “luxury” imports of all sorts, from French perfumes to German cars. Or foreign pleasure travel by Americans.

### ONLY TEMPORARY?

Instead, the Administration has pounced on the least plausible item. In the five years 1958 to 1962 the aggregate net outflow of \$16.6 billion for new foreign investment was offset by \$15.4 billion of income from previous investment. Even Secretary Dillon concedes: “In the long run the outflow of American capital to foreign countries is more than balanced by the inflow of income earned by that capital.” At best, then, the tax is shortsighted. When we give away foreign aid we get no money back. In the long run reducing foreign investments must mean a corresponding reduction in our exports.

We have succeeded only in the last 30 years in making the U.S. the financial center of the world. Why kick this national asset away?

The proposed tax is being officially urged “only as a temporary measure to meet our problem pending more fundamental solutions.” But no fundamental solutions are being considered. Such solutions would be to balance our budget, to halt our inflation, and to permit our interest rates to go to levels that would halt or even reverse the pressure for lending or investment abroad. Instead the Administration is cutting taxes, planning continued huge deficits, and insisting that money be kept cheap.

The proposed tax, therefore, will not cure anything. If the situation grows worse, the Administration will look for other scapegoats—for example, foreign travel—to blame, tax, and control. And if foreigners suspect this intention, the foreign-investment tax will have exactly the opposite of its desired effect. ❁

## World of Inflation

March 30, 1964

The billion-dollar line of credit just extended to Italy, chiefly by the United States, but with the help of a few European banks, is another dramatic illustration of the inflation epidemic now sweeping most countries in the world today, and of the intergovernmental cooperation that seems much more likely to prolong that inflation than to bring it to a halt.

The credit was extended, as dispatches put it, “to help Italy cope with a huge deficit in her balance of payments.” But what caused this “deficit” was the Italian Government’s own inflation. Since 1958, Italy’s official money supply has been increased 90 percent. In addition, the government has encouraged a huge creation of private promissory notes, popularly known as “butterflies,” that serve as a substitute for money. There is a budget deficit.

The inevitable long-run result of such policies is to raise internal prices in Italy above world levels. This tends to make Italy a poorer place to buy from and a better place to sell to. Hence it discourages exports and encourages imports. Hence it brings a “deficit” in the balance of payments and gives rise to fears concerning the stability of the lira.

### RESULT OF IMF SYSTEM

It is instructive to notice that such consequences are brought about by the world monetary system set up at Bretton Woods in 1944—the IMF (International Monetary Fund) system. They could not happen under an orthodox gold standard. The loss of gold from any country would force that country to reduce its outstanding currency and deposits to bring prices once more in equilibrium with those in the outside world. It could not happen even in a world of paper currencies with free exchange rates, because at the same time as prices rose in the inflating country its currency would fall correspondingly in the foreign-exchange market, and so restore its “balance of payments.”

Prolonged and chronic deficits in the balance of payments, such as we have been witnessing over the last two decades, can occur only when one country inflates faster than its neighbors but still tries to peg its currency in the foreign-exchange market at a fixed ratio with other currencies. Then the discrepancy of prices in that country with prices elsewhere continues. Exports shrink, imports rise. The currency can be kept at the official parity only by huge currency swaps or borrowing from abroad.

### ITALIAN EXAMPLE

Unless the U.S. Government got the strictest guarantees out of the Italian Government this billion-dollar credit was unwise, for the lira crisis could probably be halted overnight if the Italian Government stopped inflation and sufficiently raised its discount rate. It is ironic that the principal rescuer, the U.S. Government, has itself been suffering from a balance-of-payments crisis for six years and is taking no effective steps to halt the inflation that causes it.

The Italian crisis is merely the most recent. Two years ago it was Canada. A few years before that it was Britain. India is suffering from a huge balance-of-payments problem because it is trying to combine inflation and socialism with an overvalued rupee. Our Latin American neighbors have had payments crises whenever they failed to devalue enough to offset their internal inflations.

Of the original 44 currencies represented in the fund (in 1946) nearly all have been devalued (following the British action in September 1949), some of them several times. Most of the 89 currencies now in the fund have had checkered careers.

This is no accident. The whole purpose of the fund was to save countries from having to redeem their currencies in gold on demand. The whole purpose is to permit them to expand credit and currency continuously, through mutual “drawing rights,” borrowing, and “central bank cooperation.” The inflationary game can be kept going indefinitely (at the expense of the world’s bondholders, savers, consumers) as long as this international expansion is *uniform*. Danger arises only when one country starts inflating faster than the rest, and then it must be propped up by the rest. World inflation will continue as long as we keep the IMF system. ☸

## The War on Poverty

April 6, 1964

President Johnson’s call for “a national war on poverty,” with the objective of “total victory,” is going to be hard for the Republicans to combat. Who isn’t against poverty?

There is an air of moderation about the President’s proposals that adds to Republican difficulties. He asks for an added expenditure in the first fiscal year of less than \$1 billion—only, as he points out, 1 percent of our national budget.

Then again, he assures us that “The war on poverty is not a struggle simply to support people, to make them dependent on the generosity of others. It is a struggle to give people a chance.” And he follows this with

proposals for government job-training and employment programs.

But soon the thoughtful reader becomes aware that what the President is proposing is a set of more government interventions to try to cure evils brought about by previous government interventions. It is not a coincidence that so much of the unemployment that exists today in this country is among the unskilled. One of the chief reasons is the Federal minimum-wage law. Hundreds of thousands who could otherwise find work are kept out of the labor market altogether if their earning power is less than \$1.25 an hour.

### THE CAMEL'S HEAD

A generation or two ago a young beginner might work for nothing until he learned the business. His father might even pay an employer for his training. Today minimum-wage laws and union restrictions make such apprenticeship on an adequate scale practically impossible. So, under the poverty program, workers are to be trained at taxpayers' expense. But we may be sure that each union will oppose this free job-training by government.

Another doubt likely to occur to the thoughtful observer is whether Mr. Johnson can achieve "total victory" over poverty with an expenditure of only \$970 million a year. This comparatively tiny price tag for such a vaultingly ambitious goal, one suspects, is merely a way of getting the camel's head in the tent. If the history of social security is any guide, we can expect the price tag to increase geometrically as the years go on.

In fact, we may not have to wait long. On the very day that the President's program was announced, the head of the National Farmers' Union declared that it represented "only an infinitesimal fraction of what needs to be done to wipe out poverty in America. . . . We should be talking about tens of billions of dollars." This, of course, would lead to a wild inflation that in the long run would only multiply the poverty problem.

### WAGE WITHOUT WORK

A few days after that, a 32-member group calling itself the Ad Hoc Committee on the Triple Revolution declared that every American should be guaranteed an adequate income as a matter of right whether he works or not. This fantastic proposal would destroy all incentive to work, not only on the part of those who expected to be supported, but on the part of those who would be asked to support them out of their own earnings. There could be no faster way to impoverish the nation.

The only real cure for poverty is capitalism—the system of private property, free markets, and free enterprise. This system has made us the most productive and richest nation in the world. It has continued to achieve

its miracles even in the last generation. It has raised the average weekly factory wage from less than \$17 in 1933 to \$102 today. Even after the rise in prices is allowed for, it has more than doubled our real per capita disposable income—from \$923 in 1933 to \$2,127 in 1963.

As some commentators have already pointed out, the state known as poverty is relative, not absolute. What we call poverty in the U.S. would be regarded as affluence in Africa, Asia, or Latin America. And in any system that allots its rewards in proportion to skill and output there will always be a bottom fifth, no matter how high average income goes. But impatient efforts to wipe out poverty by severing the connection between effort and reward can only lead to the growth of the Leviathan state and destroy the progress this country has so dearly bought. ❁

## Foreign Scapegoats

April 13, 1964

Will we recognize in time that it is our own unsound policies that have been causing the deficit in our balance of payments (with our loss of gold) in thirteen of the past fourteen years? Will we adopt corrective measures before it is too late? The outlook is not promising. In fact, nothing more disheartening has occurred in this regard than the publication (on March 19) of a report on the U.S. balance of payments by the Congressional Joint Economic Committee.

The report puts all the blame on foreigners. The U.S. has been altogether virtuous. "The main factors contributing to this unfavorable payments position have been substantial currency devaluations by other countries, the rebuilding, with American help, of the war-damaged economies of Europe and Japan, and heavy commitments abroad for private investment, economic and military assistance, and defense programs." Not a word (except for a few Republican footnotes) about the 28 deficits in the Federal budget in the last 34 years, nor about the multiplication in our issue of paper dollars, nor about our cheap-money policies.

It appears that our deficit has been caused by the bad policies of the countries that have a surplus. For these wicked countries "counter inflation with tight-money policies and high interest rates." This embarrasses our own inflation by encouraging capital export and dollar export. The committee suggests that these countries either follow inflationary cheap-money policies so that we can keep our own going, or revalue their currencies upward.



### BEAM IN OUR OWN EYE

The committee self-righteously accuses the surplus countries of imposing “quantitative restrictions on imports, controls on capital exports . . . [and] export subsidies. These measures are inconsistent with free market economic principles and have contributed substantially to the U.S. balance-of-payments deficits.” This blandly ignores that our government itself imposes quantitative restrictions on imports (e.g., sugar and oil), has asked for a punitive tax on the purchase of foreign securities, and pays export subsidies on farm products.

But the committee’s recommendations are even worse than its diagnosis. Because, at the end of 1963, only \$2.6 billion of the total U.S. gold stock of \$15.6 billion was “free” gold available to “defend the dollar,” because this “free” gold reserve has declined by an average of nearly \$1.4 billion a year since 1957 and might be “eliminated within two or three years,” the committee recommends that “The U.S. gold stock should be freed immediately of its domestic reserve function and made fully available for international monetary purposes.”

### THE LAST BARRIER

This recommendation can only shake confidence in the dollar. The reasoning behind it is ironic: “For many years U.S. residents have not been permitted to redeem their dollars in gold. The only remaining domestic function of gold is to place limits on the expansion of the domestic money supply. But this expansion can be limited equally well without requiring a gold reserve against Federal Reserve liabilities.”

Now the *chief* function of a minimum legal gold reserve has always been precisely to place limits on the expansion of the money supply. If even the 25 percent legal gold reserve had been combined with the requirement of domestic as well as foreign convertibility, the enormous expansion of the U.S. money supply in the last 30 years could not possibly have taken place; the Treasury would have been long since drained of its gold. The official argument at the time American citizens were deprived of their right to convert to gold was that all that was really necessary was to maintain convertibility *for foreigners*. But now that we have issued so many paper dollars as to threaten even our ability to do that a Congressional committee is asking for the repeal of even that 25 percent requirement—i.e., of the last legal barrier to more inflation.

The last recommendation of the committee, to “expand international liquidity,” means that its proposed ultimate cure for our own monetary ills is a worldwide inflation. ❁

## Dilemma of Foreign Aid

April 20, 1964

In 1947, when the foreign-aid program was first launched under the name of the Marshall Plan, I wrote a critical book on it called *Will Dollars Save the World?* In it I pointed out, among other things, that intergovernmental grants raised an insoluble problem regarding conditions:

“Intergovernmental loans are on the horns of this dilemma. If on the one hand they are made without conditions, the funds are squandered and dissipated and fail to accomplish their purpose. They may even be used for the precise opposite of the purpose that the lender had in mind. But if the lending government attempts to impose conditions, its attempt causes immediate resentment. It is called ‘dollar diplomacy’; or ‘American imperialism’; or ‘interfering in the internal affairs’ of the borrowing nation.”

In the original debates on the foreign-aid program this dilemma was simply ignored. Even in the seventeen years since then it has been only dimly and occasionally suspected. Thus our government has alternated between one policy and the other. For a time it would try to attach conditions. When this gave rise to outcries of “Yankee domination” our government would hasten to assure the recipients that the aid was offered “without strings.” Then when the aid was shockingly abused we would return to a halfhearted insistence on some conditions.

### SUBSIDIZING SOCIALISM

Today we seem to be following the worst policy of all. We have been imposing conditions, but exactly the wrong conditions. We tell our neighbors in Latin America that they will get aid in proportion to their commitment to “programs of economic and social progress.” But we have been interpreting this phrase to mean “land reform,” subsidized housing, bigger social-security payments, i.e., programs of *government* planning and socialization. (The Johnson Administration, however, has recently given signs of recognizing the dangers in this policy.)

What we have to recognize (as I pointed out in my 1947 book) is that the dilemma of conditions “is, in fact, inherent. It lies in the attempt of one government to bribe another into following economic policies which that other government does not believe in sincerely enough to follow without the bribe. The dictation must be resented even if accepted. The people in the borrowing nation are led to feel that they have sold their economic birthright for a mess of pottage. Everything that goes wrong is blamed on the conditions [of the aid].



The ill will caused by this is in itself enough to offset any good will [the aid] might have brought.”

### TO MAXIMIZE GROWTH

This dilemma of conditions does not arise in private foreign investment. Such investment, in the first place, is usually in private firms. If a business in Ruritania, say, seeks a loan from American investment bankers, the conditions suggested by the American bankers are not essentially different from those that would be suggested by Ruritanian domestic investors. The American private investors would ask whether the proposed new plant promised to be profitable, what guarantees were offered, etc. If the applicant for a loan were the Ruritania government itself, foreign investors would not be interested unless the government seemed likely to balance its budget, to refrain from printing more money, from exchange control, and so on.

In short, the loans would not be politicalized. They would encourage free enterprise, instead of socialism, in the borrowing countries. They would tend to go into the most profitable enterprises—i.e., into the enterprises that promised to maximize real wealth creation. They would tend to promote maximum economic growth.

Government-to-government foreign aid has the opposite effect. It tends to discourage or drive away private foreign investment, because the recipient nations get this aid without making the necessary fiscal or monetary reforms. Worse, the American Government, in order to continue to make it possible to give away foreign aid that is wasted and abused, has asked for a punitive tax on the very private foreign investment that tends to maximize world economic growth. ❁

## World Monetary Order

April 27, 1964

In a recent speech delivered in Johannesburg before the South African Institute of International Affairs, the eminent European economist, Wilhelm Röpke, called attention to the dangers both of our present “world without a world monetary order” and of American domestic policies that are weakening the dollar and “exporting inflation” to the rest of the world.

The prevailing impression is that the International Monetary Fund has given us a kind of world monetary order. Professor Röpke admits that this represents some improvement over the situation only ten years ago, which still deserved no better name than that of international economic disintegration. But he does not see the IMF system as one that provides any reassurance for

the future. The present international monetary system, he declares, “has become an enormous world machinery for breeding and transmitting inflation.”

The United States, for example, because of inflationary policies, has a deficit in its balance of payments. This means that gold and dollars have been flowing abroad, where they become reserves against which Europe creates its own additional currency and bank deposits. But while these countries thus “import” inflation, the U.S. not only refuses to deflate but even to stop inflating.

### U.S. WAGE INFLATION

“The root cause of the balance-of-payments difficulties of the United States is the internal wage and fiscal inflation which has been allowed to develop in that country during the last decade. The official assurances that these sources have been stopped carry little conviction because both wage inflation and budget deficits financed by bank reserves rather than by genuine savings have increased without interruption. It is not sufficient in the American case merely to hold wage increases within the limits which the government has designated as . . . socially desirable.”

Röpke goes on to quote in support of this judgment the words of Dr. Holtrop, the president of the Dutch central bank, in his annual report: “In the private sector the exports of both goods and capital would without doubt be favorably affected by a lowering of American production costs. To this cost aspect, however, too little attention is as yet being paid. Most of those who discuss wage policy at all confine themselves to saying that wages must not rise more than the improvement of per capita productivity permits. But in the case of countries with an obstinate balance-of-payments deficit that standard is inadequate. Countries in that position can perhaps stand some raising of real wages, but hardly a rise of nominal wages.”

### A RETURN TO GOLD

Professor Röpke continues: “Since the American monetary authorities, however, dare neither to let the unemployment caused by trade-union power take its course nor to neutralize it altogether by a correspondingly full measure of inflation, the sad result is that the United States is that country which, in the midst of all its incomparable wealth, has managed to have both some measure of inflation and a large volume of unemployment, in other words, the worst of two worlds. The intemperance of the American unions is, in turn, bolstered up both by the Administration’s policy of deliberately favoring organized labor and by its overall economic philosophy. The latter is based for the most part on monetary expansionism of a rather extreme

kind. . . . In the meantime, no stone is left unturned to mobilize foreign help for supporting the sick dollar.”

But as Professor Röpke points out, this cannot cure the real illness. The immediate solution is a reform of American policies, and the ultimate solution is a world return to a full gold standard.

Readers of this column will not be unfamiliar either with the diagnosis of the defects of the IMF system, the criticism of American fiscal, monetary, and labor policies, or the proposed cure of a return to the full gold standard that Professor Röpke recommends. But I report his views in the hope that Washington will be more impressed by this testimony from one of the outstanding authorities in Europe. ❁

## Inflation vs. Growth

May 4, 1964

In practically every country of the world today the great fetish is an increase in the rate of “economic growth.” And the almost universal assumption is that that can best be promoted by inflation.

This policy, however, is almost never recommended under that name. The growth planners simply argue that growth has been slow because of an “insufficiency of aggregate demand.” They think this can be rectified by more government spending. Some of them are candid enough openly to advocate government deficits and the creation of more money, i.e., inflation.

Those who propose the inflationary solution for unemployment usually forget to ask what has caused the unemployment. The cause is nearly always some discoordination of prices and wages. An injection of new money can, it is true, at least temporarily increase employment if it restores wage-price coordination if, for example, it leads to increased demand or higher prices for products without leading to higher wage rates.

Yet any price-wage adjustment brought about by inflation is likely to be only temporary. For unions, encouraged by demand for more workers, or trying to “catch up” with higher living costs, will demand still higher wages, with the result that the discoordination of wages and prices may occur all over again, and the situation can be cured once more only by a still fresh dose of inflation. On the other hand, if governments follow sound labor policies, inflation is unnecessary.

### ILLUSORY PROFITS

Inflation is not only unnecessary for economic growth. It is the enemy of growth. It distorts and falsifies economic calculation. An economy grows and functions

at its maximum rate, and the production of thousands of different commodities and services can be kept in optimum balance when producers, on the basis of current prices and wages, can make reasonably correct anticipations of supply and demand, of costs, profits, or losses.

But when inflation forces up prices, prices do not all rise in the same proportion or at the same rate.

Businessmen cannot distinguish between what is lasting and what is merely temporary, or know what the future demands of consumers will be or what the real costs of their own operations are. Depreciation and replacement allowances will be inadequate. Profits will be overestimated. Businessmen everywhere will be deceived. They will be using up their real capital when they think they are increasing it. They will think they have profits or capital gains when they really have losses.

By distorting economic calculation and creating illusory profits, inflation destroys the function of the free market in penalizing inefficiency and misjudgment and rewarding efficiency and good judgment. Because nearly everything seems to prosper, there are all sorts of maladjustments and investments in the wrong lines. Solid work tends to give way to speculation and gambling.

### EFFECT OF CONTROLS

The price and wage rises brought about by inflation will lead to demands for price and wage controls. But such controls will reduce and distort production, and do far more harm even than the inflation itself.

What is likely even before price controls is some sort of exchange control, to prevent the quotation of the home currency from falling in terms of other currencies. But the effect of such exchange controls will be to bring about a deficit in the balance of payments. It will discourage exports, because they will be overpriced compared with foreign goods. It will encourage imports. The exchange authorities, to prevent this, will institute quota and licensing systems. But these will disrupt foreign trade and domestic production.

Thus the long-run effect of inflation can only be to distort production and to retard economic growth. Of course, this effect can be concealed from many people for a long time. For prices and wages and incomes will all be constantly going higher in dollar terms. The official gross national product figures will be constantly soaring. The euphoria can temporarily lull all misgivings. But eventually the bitter moment of truth must arrive. ❁

## Argentina's Problems

May 11, 1964

BUENOS AIRES—My chief impression after a three-week lecture tour in Latin America (one week in Guatemala, two in the Argentine) is that the two countries I visited would be immensely better off if their respective governments, as well as a flock of international agencies, would only let them alone for a while, and stop trying to “aid” them, to “stabilize” them, or to speed up their “economic growth.” But then, I suspect, this conclusion would apply to many other countries as well.

The Argentine is still suffering from the consequences of Perónism. Before Perón came into full power in 1946, the country was prosperous and progressive. The economy was comparatively free, the currency stable. The peso was 4 to the dollar. As I write, the peso is 136 to the dollar—one thirty-fourth of its former value. Since 1940 the money supply has been increased 50 times, the cost of living 65 times.

Not all of this happened under Perón. The inflation still goes on. Perón was forced out in 1955. Yet the cost of living in the Argentine is nearly six times as high today as it was in 1958. And no one seems to know how the inflation can be brought to an end. The deficit is out of control. In the first five months of the current fiscal year, revenues covered only 37 percent of expenditures. The cash deficit is running at an annual rate of 169 billion pesos. Yet the government shows no disposition either to cut expenditures or to raise taxes. A large part of the budget deficit consists of deficits in government-owned and government-managed industries, particularly the railroads. It is estimated that on railways alone (loaded with excess employees) the deficit for the current year will reach 60 billion pesos.

### DOLLAR RESTRICTIONS

The government blames the depreciation of the peso on “speculation.” On the very weekend of my arrival (April 12), it promulgated a set of currency restrictions forbidding the transfer of gold, currency, and securities out of the country, severely limiting travel allowances, restricting dollar and other foreign-exchange purchases, and ordering the exchange of dollar export earnings into pesos within five days after receipt.

Of course the effect of these measures can only be the opposite of that intended. When dollars are not free to go out they will not come in. When Argentine businessmen and others are restricted in the amount of dollars they can buy or send out each month they will use this permission to the limit—and look for other ways to send out more. On the first business day following the

new controls an international black peso-dollar market started up with its center in Montevideo, in which the peso went to a further discount in dollars.

### HERITAGE FROM PERÓN

One reason for the alarm was that too many people remembered the graft and disruption that followed the imposition of exchange controls under Perón. Practically the whole press, with the exception of the extreme left and the Perónistas, opposed the new measures—for the most part with remarkably well-reasoned arguments. A particularly brilliant analysis of their probable effect was published by Rodolpho Katz in his *Economic Survey*.

I had an interview with President Arturo Illia, who has been in office since last July. I was impressed by his ease and informality, his courtesy, modesty, and open-mindedness, and his sincerity. He believes that the new exchange restrictions are temporary, and that there will be no need to broaden them. But many Argentines wonder about his understanding of economic affairs and deeply distrust some of the economic advisers around him.

As for Guatemala, I have left myself room only to remark upon the complex system of price controls and production quotas that the United States has forced upon Guatemala through the International Coffee Agreement which we sponsored. Our government has promoted nationwide union monopolies, nationwide crop-price supports and acreage controls, and compulsory world price-fixing and quotas in coffee and other commodities. But when American businessmen attempt the same thing on a comparatively tiny scale, it puts them in jail for it. ☸

## Inflation in Europe

May 18, 1964

Even economists who originally favored a tax cut as an economic stimulus are beginning to express fears that the recent one was excessive and may touch off an inflationary boom in the current year. Many of them had assumed that the tax cut in the first year would be between \$4 billion and \$5 billion. The cut of \$11.5 billion (or even \$13 billion as estimated by some economists) may, they fear, be so large as to “introduce a destabilizing force.”

These misgivings are not unjustified, and could be based on more than the tax cut itself. It is obvious that the government intends to finance the deficit by borrowing from the banks, i.e., by inflation. In fact, the



U.S. money supply was being increased with unusual rapidity even before the tax cut took effect. If we define the money supply as demand deposits plus currency, it grew at an annual rate of 4.2 percent from August 1962 to March of this year, compared with an average annual rate of 2.2 percent from 1951 to 1963. If we define money supply to include time deposits, it has grown over the last three years at an annual rate of 8 percent, far above its long-term average.

### DIFFICULTIES

A number of European economists, in these last three years, have been telling us that we are not inflating enough; that we ought to have even bigger deficits, and increase our money supply even faster, if we want to "increase effective demand," and bring "full employment" and a "higher rate of growth." But the First National City Bank of New York, in a series of four tables in its May letter, shows that the chief European countries have now got themselves into serious difficulties as a result of pursuing just such policies. These tables show, respectively, the increase in consumer prices, wages, money supplies, and industrial output, in 1961, 1962, and 1963, over the preceding year, and the cumulative increase over the three years 1961–63, in each of eight countries. I have condensed three of these into a single table (right) showing the cumulative three-year increase.

Several significant conclusions may be drawn from this table. Europe's recent inflation has been attributed to wage increases and other "cost-push" factors, but it is quite clear that neither the wage nor the price increases could have taken place without an increase in the money supply to permit or promote them.

It is true that, in one sense, Europe in the last few years has had an "imported" inflation—built on gold and dollars from the United States. But the European central banks were not obliged to build a pyramid of credit on this imported gold and dollars. They could simply have allowed these imports to build up their reserve ratios, or they could have correspondingly reduced holdings of domestic assets.

This European inflation has not helped European economic growth. It has undermined the competitive position of several countries. Because of the rise of wages beyond marginal productivity, it is estimated that wage costs per unit of production increased from 1959 through 1963 by 17 percent in the Netherlands, 20 percent in Germany and France, and 28 percent in Italy. The increase was about 10 percent in the United Kingdom and nil in the U.S.

True, this European inflation has hurt the exports of some of these countries and sucked in imports, giving France and Italy, for example, deepening trade deficits.

One incidental result has been to make our own balance-of-payments problem less than it would have been.

### Percent increase 1961–63 in . . .

	Prices	Wages	Money
Belgium	3.91	9.8	26.7
France	13.6	29.6	57.1
Germany	9.8	32.2	31.9
Italy	14.7	23.8	57.7
Netherlands	6.8	24.1	25.9
Switzerland	9.9	18.1	37.1
United Kingdom	10.9	12.4	8.4
United States	3.5	8.8	8.8

But it would be folly to assume that the problems brought about by our own inflation can be solved by European inflation. These inflations may help to encourage and prolong each other; but the prospects of international long-term stability and growth are only hurt by them. ☸

## Industrialitis

May 25, 1964

In government circles in nearly every "underdeveloped" nation today there is a fixed idea that the economic salvation of the country lies in industrialization.

Among outstanding examples are Egypt with its zeal for dams and India with its mania for a government steel mill. But examples can be found everywhere. I met a typical one in a recent visit to the Argentine. Argentina has now imposed a practical prohibition on the import of foreign cars in order to create a home automobile industry that not only assembles cars but makes the parts for them. Some of the chief American and foreign producers have established plants there. But it is estimated that it costs today about two-and-a-half times as much to make a car in the Argentine as it would to import one. Argentine officials are apparently not worried about this. They argue that a local automobile industry "provides jobs," and also that it sets the Argentine on the road to industrialization.

Is this really in the interest of the Argentine people? It is certainly not in the interest of the Argentine car buyer. He must pay, say, about 150 percent more for a car than if he were permitted to import one without duty (or by paying a merely nominal revenue-raising



duty). Argentina is devoting to car-manufacture capital, labor, and resources that could otherwise be used far more efficiently and economically—by producing more meat, wheat, or wool, say, to buy automobiles rather than to make them.

### REDUCED EFFICIENCY

The effect of all government-forced or subsidized industrialization is to reduce overall efficiency, to raise costs to consumers, and to make a country poorer than it otherwise would be.

But the authors of the import prohibition might reply with a form of the old “infant industries” argument that played such a large part in our own early tariff history. They may contend that once they can get an automobile industry established, they can develop the domestic know-how, skills, efficiencies, and economies that would enable an Argentine automobile industry to be not only self-supporting but capable of competing with foreign-automobile industries. Even if this claim were valid, it is clear that a protected or subsidized industry must be a loss and not a gain to a country as long as the protection or subsidy has to be retained.

And even if a self-supporting motor-car industry were finally established, it would not prove that the losses in the period of hothouse growth were justified. When the conditions are in fact ripe in any country for a new industry capable of competing with the equivalent foreign industries, private entrepreneurs will be able to start it without government subsidies or prohibitions on foreign competition. This has been proved again and again within the United States, for example, when a new textile industry in the South competed successfully with the long-established textile industry in New England.

### AT ANY COST?

There is another fallacy behind the industrialization mania. This is that agriculture is always and necessarily less profitable than industry. If this were so it would be impossible to explain the prosperous agriculture within any of the industrialized countries today.

A popular argument of the industrialization-at-any-cost advocates is that it is impossible to point to a purely agricultural country that is as wealthy as “industrialized” countries. But this argument puts the cart before the horse. Once a dominantly agricultural economy becomes prosperous (as the early United States) it develops the capital to invest in domestic industries and therefore rapidly becomes a country of diversified production—both agricultural and industrial. It is diversified because it is prosperous rather than prosperous because it is diversified.

It is the great superstition of economic planners everywhere that only they know exactly what commodities their country should produce and just how much of each. Their arrogance prevents them from recognizing that a system of free markets and free competition, in which everyone is free to invest his labor or capital in the direction that seems to him most profitable, must solve this problem infinitely better. ❁

## Testing by Results

June 1, 1964

It is doubtful whether any other type of public regulation of economic activity has been so widely admired as the regulation of the securities markets by the Securities and Exchange Commission. The purpose of the regulation is to compel full disclosure of the facts about a security and to prevent or punish fraud. No one can defend ignorance or fraud. But have the SEC and the complex regulations it enforces in fact achieved their intended purpose of protecting the investor? And did they pay their cost?

This is the question that Prof. George J. Stigler of the University of Chicago set himself in the April issue of the *Journal of Business* published by that university. He assumed it might be capable of statistical answer. So with the help of an associate he compared the fate of new issues of securities in the period of 1923 to 1928, inclusive, before the SEC, with the fate of new issues of securities in 1949 to 1955, inclusive, after the SEC. He examined what happened to the market prices of new issues, in each period, in each of the five years after they came out. To eliminate the effects of general market conditions, he compared these market prices, not absolutely, but relative to the market average.

### SEC AND INVESTORS

His results were negative. That is, his comparisons “suggest that the investors in common stocks in the 1950s did little better than in the 1920s, indeed clearly no better if they held the securities only one or two years,” and “that the SEC registration requirements had no important effect on the quality of new securities sold to the public.”

He arrived at “two main conclusions: (1) it is possible to study the effects of public policies, and not merely to assume that they exist and are beneficial, and (2) grave doubts exist whether, if account is taken of costs of regulation, the SEC has saved the purchasers of new issues one dollar.” In a footnote he adds: “The costs of the program, that is, probably exceed even a reasonably optimistic estimate of benefits.” Allowing for “costs of

the delays imposed . . . as well as costs of operating the SEC, the full costs of registration for new stock issues could be 5 percent of their value.”

Stigler’s statistical results are of course not conclusive. In a matter of this nature, no statistical result could be conclusive. For the question to be answered is: what would have happened if there had been no SEC regulations? And might-have-beens can never be proved. But Stigler’s statistical results from comparisons of the pre-SEC with the post-SEC at least raise a strong presumption. There is no evidence that investors fared any better after the SEC was given control over the registration of securities than they did before.

### DID CONSUMERS SAVE?

Earlier, Stigler and an associate undertook a study of the effects of state regulatory commissions on the electric-utility industry. They came to the tentative conclusion that these effects had been quite small: “It is very doubtful whether consumers have been saved as much by public regulation of the electrical utilities as they have had to pay, directly and indirectly, for regulation.”

Yet historically, regulation of the electric utilities tends to increase rather than diminish; and since the SEC was established it has increased year by year the scope and complexity of its regulations and requirements and asked for increased powers. As Stigler puts it:

“One great invention of private enterprise . . . is bankruptcy, an institution for putting an eventual stop to costly failure. No such institution has yet been conceived of in the political process, and an unsuccessful policy has no inherent termination. Indeed, political rewards are more closely proportioned to failure than to success, for failure demonstrates the need for larger appropriations and more power.”

The prevalent economic ideology has entirely forgotten the function of the free market. It assumes that the solution of every problem must be more government intervention, more government control, and more government spending. It is being carried along by its own momentum, and disdains the application of any factual tests to its results. ❁

## Will We Ever Pay Off?

June 8, 1964

In 1930, the national debt was \$16 billion. In 1945, at the end of World War II, it was \$260 billion. During the war, while the debt was piling up, the general assumption was that this borrowing was proper and even unavoidable in a time of crisis, but that once the war was over the debt would be gradually reduced or

paid off. Instead, in the eighteen years since the end of the war, the national debt has been increased to \$308 billion, or an average of \$6,500 for every family in the United States.

Today interest on the debt alone amounts to \$11 billion a year, or more than three times as much as the government spent annually for all purposes in the years 1926 to 1930.

There is curiously little concern about this. On the contrary, every once in a while some writer emerges to ridicule what little concern there is. J. David Stern did this in the January *Atlantic*. Even academic economists belittle the problem.

Stern’s argument was summed up in the statement that “the nation is growing faster than its debt.” One academic economist, trying to prove the same point, epitomized his argument in the following table:

	1945	1963
National debt	\$260	\$305
Gross national [product]	214	585

The triumphant conclusion the professor drew from this table was that “the national debt, when viewed as a burden to a year’s production, has been more than cut in two.”

### DEBT VS. GNP

The figures are official, and the conclusion is technically correct. The complacency of the conclusion is unjustified.

The reason the national debt is less of a burden is that, through inflation, the purchasing power of the dollar has been steadily reduced. It has been reduced 63 percent since 1933 and 43 percent since 1945. Let us state this another way. By failing to balance its budget, by borrowing, by monetizing the debt, by printing more dollars, by steadily diluting the dollar’s purchasing power, the government has in effect repudiated 63 cents of every dollar it borrowed in 1933 and 43 cents of every dollar it borrowed in 1945.

To put it bluntly, the creditors, the holders of U.S. Government bonds, have been cheated.

Let’s make this even clearer by an illustration from another country. At the end of 1923, the purchasing power of the German paper mark fell to less than one-trillionth of its 1913 value. This meant that prices rose more than a trillion times. Therefore Germany’s “GNP,” measured in paper marks, rose more than a trillion times. As a result, its accumulated debt, represented by borrowings of marks of a much higher purchasing

power, was reduced to practically no burden on the economy at all. Though Germany was the extreme case, the situation did not differ in principle from what happened in France (where the franc eventually fell to less than one one-hundredth of its 1913 value) and a score of other European countries.

#### 'A PRETENDED PAYMENT'

Adam Smith, writing in 1776, was perfectly familiar with this method of disguised repudiation. "When national debts have once been accumulated to a certain degree," he wrote, "there is scarce, I believe, a single instance of their having been fairly and completely paid." But governments usually covered "the disgrace of a real bankruptcy" by the "juggling trick" of "a pretended payment" in depreciated currency.

So the relationship that seems to give some present-day writers so much satisfaction—that the national debt, in dollar terms, has been falling in relation to the gross national product in dollar terms, is simply the outcome of the steady depreciation of the dollar. The more inflation we have, and the more the purchasing power of the dollar is depreciated, the more the national debt will "fall" in relation to the GNP, because the GNP, measured in rising prices, will rise in relation to the debt, and so these writers will have increasing reasons for statistical satisfaction.

Do we have any serious intention of ever paying off our national debt in dollars of at least present purchasing power? If so, isn't it about time we balanced the budget and made an honest start? ❁

## When Inflation Sours

June 15, 1964

Italy in recent years has been Europe's fastest growing economy. In the ten years ended in 1963 its total statistical output of goods and services more than doubled. But now it has been suddenly plunged into what the *Wall Street Journal* calls "the worst economic distress to hit any member of the European Common Market since shortly after the Market's 1958 birth."

Italy's apparent economic miracle was at least partly the result of its inflation. This inflation was also the greatest in any European country in the last three years. In those three years prices in Italy increased 14.7 percent, wages 23.8 percent, and the money supply 57.7 percent. But Italy's imports have soared. It suffered a balance-of-payments deficit last year of more than \$1 billion, draining its reserves of dollars and other foreign exchange. The Italian Government has been forced to

tighten credit. Unemployment has reappeared. Stock prices on the Milan exchange have fallen to the lowest level in four years.

Italy is merely the latest illustration of the truth of the warning issued recently by Robert Marjolin, vice president of the Common Market's Commission: "Sooner or later, continuing inflation will lead to a halt in expansion or even to a recession, touched off by automatic factors . . . and also by government action. This action will have to be more drastic the longer it is deferred."

#### THE EUROPEAN RECORD

Yet inflation in other European countries, in France, Belgium, Holland, Germany, Switzerland (discussed in this column of May 18), has been only slightly less in extent than that in Italy. Both wages and prices have been rising faster in Europe than here. According to the figures of the International Monetary Fund, wages in the U.S. and Britain rose only 3.5 percent last year, but in Germany 7, in Belgium 7.6, in Holland 7.8, in France 8.8, and in Italy 10.2 percent. Similarly, consumer prices in the U.S. rose only 1.2 percent last year, but in Belgium 1.9, in Britain and Germany 2.8, in Switzerland 3.7, in Holland 3.8, in France 5, and in Italy 7.3 percent.

As a result of this situation, there has been a shift in the balance of payments. Our situation has improved. In the first five months of the present year the deficit in the U.S. balance of payments shrank to a seasonally adjusted annual rate of about \$1.5 billion, compared with \$3.3 billion in the calendar year 1963 and \$3.9 billion in 1960.

#### THE U.S. RECORD

Yet this should not be a reason for American complacency. We are still running a deficit in our balance of payments, not a surplus. And though the rate at which this deficit is piling up has slowed down, we should not forget that this deficit is cumulative. In the six years from the end of 1957 to the end of 1963 it has amounted to \$19 billion. Foreigners now hold \$25.9 billion of our short-term liabilities, and our gold stock is down to \$15.7 billion.

We cannot count on being bailed out by European inflation. We too are still inflating. Since the end of 1962 we have increased our money supply by 5 percent, and, including time deposits, by 10 percent. In April our consumer price index went to the highest level on record.

Yet our government officials, instead of trying to halt our inflation, criticize European countries for



trying to halt theirs. Secretary Dillon told a Vienna conference that raising interest rates to discourage an inflationary expansion of credit was not an “appropriate” way to fight inflation. Is that because higher interest rates abroad cause capital to flow out of the U.S.? Instead of allowing higher compensatory interest rates here, our Treasury prefers to hold interest rates down and to tax American investments abroad. Yet while it discourages sound private foreign investment, our government contributes most of a \$1 billion credit to prop up the inflated Italian lira.

In a recent survey the National Industrial Conference Board found that in 39 countries living costs have risen in the last five years in every country but El Salvador. Today inflation is considered the great economic panacea. But what happens when, as in present-day Italy, an inflationary boom begins to turn sour? ❁

## What Happens to Aid

June 22, 1964

When Nehru died, a number of newspapers pointed out that whatever his merits may have been, he had failed to solve India's economic problems. Millions of Indians still live in abject poverty. Ninety percent of the houses in the country are one-room hovels, with no facilities whatever. Food consumption by the masses continues below acceptable standards. The use of cloth has steadily declined. India's national income rises only about 2 percent a year, roughly the same as population growth. Industry is stagnant. Unemployment has risen.

And all this is in spite of massive foreign aid. Since 1948, the United States has spent \$5.3 billion in all sorts of aid to India, from outright grants to loans and sales of surplus farm commodities for rupees. The week before Nehru's death a consortium composed of the World Bank and ten nations pledged more than \$1 billion for the fourth year of India's current Five-Year Plan.

India's poverty is immemorial. But the failure of conditions to improve in the seventeen years of Nehru's rule, even with these massive doses of foreign aid, is not mysterious. India's economic growth has been choked by the economic, fiscal, and monetary policies that Nehru and his party imposed on the country.

### DOCTRINAIRE SOCIALISM

Nehru was a doctrinaire socialist. The establishment of a socialist society was, in fact, the principal goal of Indian economic planning. This objective was formally accepted by the Indian Parliament in 1954. In the words of the second Five-Year Plan: “The adoption of

the socialist pattern of society as the national objective, as well as the need for planned and rapid development, require that all industries of basic and strategic importance, or in the nature of public utility services, should be in the public sector.”

In various ways the Indian Government has been throttling what is left of private industry, and diverting production into uneconomic channels. Government-imposed price controls have driven scarce funds from areas where they are most needed. Under selective and arbitrary price ceilings, investment in coal mining, cement manufacturing, and fertilizer production has lagged. Private steel mills have been starved of funds and unable to expand their facilities.

Though heavy government spending and deficits have led to inflation and rising domestic prices, the official value of the Indian rupee has remained unchanged since World War II. The result is a gross overvaluation of the rupee. Its official quotation is kept up only by exchange control. This overvaluation has penalized and discouraged exports, subsidized and encouraged imports, led to a startling increase in India's external debt, depleted its currency reserves, and caused acute shortages of foreign exchange. It is estimated that without foreign aid, India's balance-of-payments deficits would have averaged more than \$800 million annually in recent years.

### DISSERVICE TO INDIA

So our aid to India has gone mainly to subsidize and prolong socialism, price controls, and an artificial value for the rupee. As the eminent Indian economist B.R. Shenoy wrote in the May 21 issue of *The Wall Street Journal*: “Foreign aid actually is doing a disservice to the Indian economy. . . . Aside from helping to perpetuate industrial white elephants, foreign aid . . . provides the foreign exchange needed for illicit export of capital; for illegal imports of gold . . . for speculative accumulation of inventories; for the construction of urban property as a hedge against inflation; and for luxury living for those few who succeed in manipulating the nation's economic controls to their own advantage.”

In brief, aid to India, in so far as it has not been merely a futile effort to fill a leaking tub, has been encouraging and prolonging socialism, controls, inflation, and an overvalued currency. And what is happening in India is typical of what is happening in other “underdeveloped” countries into which we have been pouring taxpayers' dollars.

When, if ever, are we going to use foreign aid to encourage sound currencies, balanced budgets, private property, free enterprise, and increased productivity? ❁



## Income without Work

June 29, 1964

About three months ago (March 22), a group calling itself the Ad Hoc Committee on the Triple Revolution (not a gag) came out with a manifesto, which made the front pages, declaring that:

"The traditional link between jobs and incomes is being broken. The economy of abundance can sustain all citizens in comfort and economic security whether or not they engage in what is commonly reckoned as work. . . . We urge, therefore, that society, through its appropriate legal and governmental institutions, undertake an unqualified commitment to provide every individual and every family with an adequate income as a matter of right."

The manifesto ran to 29 typewritten pages. It carried among its 26 signers such names as W.H. Ferry of the Fund for the Republic, Gunnar Myrdal, the Swedish economist, and Linus Pauling, the ban-the-bomb scientist. It seemed too obviously crackpot, at the time, to be worth serious analysis. But lo! on June 7 the Sunday magazine section of *The New York Times* carried an article by Michael D. Reagan, one of the manifesto's signers, seriously explaining why the government should provide, say, \$3,000 a year "without question to any jobless applicant."

So perhaps the proposal is worth a second look.

### PERMANENT JOBLESS?

The first thing we may ask is whether there is any reason to accept the revolutionists' statement of facts. According to them, there is a "cybernation revolution" going on, "brought about by the combination of the computer and the automated self-regulating machine. This results in a system of almost unlimited productive capacity which requires progressively less human labor." "A permanent impoverished and jobless class" is being established. "Fewer and fewer people are involved in production of goods and services."

These statements are based mainly on the fact that "the official rate of unemployment has remained at or above 5.5 percent during the '60s." But the triple revolutionists never mention in their 29-page statement that the number of employed persons over the last twelve months, at around 69 million, is at the highest level in our history.

And they treat the unemployed as if they were a static army, though three-quarters of them are unemployed for less than fifteen weeks. Less than 1 percent of the total working force is unemployed for more than six months. This hardly suggests that the "permanent jobless class" is very large, or that "the underlying

cause of excessive unemployment" is "cybernation," or "machines taking over production from men."

### HOW MANY WOULD WORK?

Now about the remedy of a guaranteed income without work. Reagan makes the mistake of going into details that the Ad Hoc Revolutionists wisely slurred over. He would guarantee every family \$3,000 a year, but doesn't think it would cost much. For example, in 1962, 9.3 million families were earning less than \$3,000 a year. They earned an average of \$1,795. "If they are to be brought above the poverty level, they will need an additional \$1,205 per family"—or a total of only \$11.2 billion.

I suggest that there may be a few problems. This \$1,795 income is an average figure. Many families earned less, others more. But as the \$3,000 total is guaranteed anyhow, why still bother to work for their present income? And what about families earning, say, \$3,100 a year? They would get nothing from the government. Why work all year for only \$100? Wouldn't they either quit, or demand a basic \$3,000? Wouldn't *every* family demand a basic \$3,000 handout—just as old-age pensions are a flat amount regardless of one's other income? How many of us would work to support the rest?

To cut the connection between work and income is to cut the connection between production and income. The scheme would lead to diminishing production and universal impoverishment. But it is no accident that the newspapers are beginning to be filled with such utopian schemes and dreams. When President Johnson tells us he can solve the immemorial problem of poverty in his Administration he is going to encourage others to tell us that they can do it overnight. ☸

## Training for Jobs

July 6, 1964

Almost everybody knows that if a commodity is overpriced some of it will remain unsold. But hardly anyone except a few economists—certainly no union leader or politician—seems willing to recognize that wherever labor is overpriced some of it will remain unemployed.

Because this basic cause of unemployment is unrecognized or unacknowledged, union leaders and politicians blame the bulk of it on other alleged causes. The two most popular scapegoats today are "automation" and lack of training.

The automation scapegoat is by far the more frequent. We are constantly being told that it has created

a huge army of “permanent jobless.” The unemployment statistics do not support this. Out of 4.3 million unemployed in March, for example, fewer than 600,000 were unemployed for more than six months. This means that fewer than one in seven of the unemployed, and only one in every 130 persons in the total potential labor force of persons 14 years of age and over, was out of work for more than six months. The total number of *employed* persons in the U.S. has been rising each month to new high records. “Automation,” in the long run, creates as many jobs as it destroys.

### NEW BUGABOO

But recently a new bugaboo has been getting the blame for “permanent” unemployment. This is lack of training and lack of special skills. This is a real cause of temporary unemployment. But it is not in itself a cause of *permanent* unemployment. Nor is there any good reason for supposing that it is a greater cause even of temporary unemployment than it has been in the past. Yet both allegations are constantly being made. Quite recently James R. Dumpson, welfare commissioner of New York City, declared:

“The kind of unemployment we now have is the kind that isn’t eliminated by an expanding economy. The jobs that economic expansion produces go begging as far as the unemployed are concerned, because they cannot fill them. The economy has moved on—and passed them by.”

Such statements are refuted by the statistics just cited. Six out of seven of the unemployed get new jobs within six months; three out of four get new jobs within fifteen weeks.

It is true that the highest percentage of present unemployment (averaging 5.3 percent in April) is found among youths of 14 to 19 (16.3 percent) and among non-whites (9.6 percent). But a large part of the blame for this must be put on a minimum legal wage which makes it uneconomic to employ some of these people, who would otherwise be employed at a lower rate (which could still yield an income above the typical relief payment).

### LEARNING BY DOING

The question remains of unemployment through lack of adequate training and skill. There is no good reason for thinking that the percentage of this unemployment would be substantially higher today (without the minimum-wage law) than in the past. At all times some industries are contracting while others are expanding. Some skills are being rendered useless while others are coming into demand. But before the minimum-wage laws and abuse of union power this situation was taken care of by the system of apprenticeship.

Apprenticeship has been well defined as “a contractual relationship between an employer and a worker under which the employer is obliged to instruct the worker, and the worker is to serve the employer, on stated terms.” It is learning by doing; it is on-the-job training; it is learning to swim in the water. Government training programs are no substitute for this. They are a burden on the taxpayer and far less helpful to the worker.

Apprenticeship can be encouraged mainly by removing the legal and union obstacles that have been put in its way. Minimum-wage requirements could be removed entirely from bona fide apprentices. And it may be pointed out that even government subsidies for on-the-job apprentices (though I do not necessarily advocate such subsidies) would be far less expensive, far more effective, and add to production more than relief or than present government work-training programs and those proposed in the anti-poverty bill. ☼

## Rigging Interest Rates

July 13, 1964

In the issue of June 15 I referred briefly to the disturbing speech of Secretary Dillon in Vienna on May 21, in which he chided European governments for keeping their long-term interest rates too high, and told them that this was not an appropriate way to fight inflation. That speech calls for further examination.

The reason for Dillon’s concern is not mysterious. If long-term interest rates in Europe average around 6 percent, while they range here between 4 and 5 percent, then foreign and even American investors will want to invest in Europe, where they can get a higher return, rather than here. The result, as Secretary Dillon and his advisers see it, is that this will prolong and increase that “deficit in the balance of payments” about which the Administration is so concerned. “Europe’s” inconsiderateness in pushing its interest rates so high “left us,” according to the Secretary, “no recourse but direct government action.” That action was to recommend a stiff tax penalty on American purchases of foreign securities.

Let us look at some of the dubious assumptions behind this reasoning.

### A PRICE PREMIUM

Dillon talks as if “Europe” is *intentionally* keeping long-term interest rates high. But European governments and private borrowers certainly don’t want to pay any higher interest rates than they have to. What has happened is simply this. European governments had *already*

been following for the last few years the inflationary policies that Dillon assumes to be needed. (He declares that “the prevention of inflation remains vitally necessary,” but the policies he has been carrying out increase inflation.)

European inflation over the three years 1961 to the end of 1963 led to average price rises of 9.8 percent in Germany, 10.9 percent in Britain, 13.6 percent in France, and 14.7 percent in Italy. (See this column May 18.) European long-term interest rates are high because they contain a “price premium” which reflects a fear of further inflation. Even Dillon concedes that “relatively recent experience with inflation has discouraged post-war European investors from the purchase of bonds.”

It is not Europe that has been artificially holding long-term interest rates up, but our government that has been artificially holding them *down*. We have done this by increasing the money supply. Since the end of 1957 the money supply, including time deposits, has been increased \$79 billion, or 40 percent. One of the chief ways in which it has been increased is by the purchase and monetization, by the Federal Reserve System, of \$34.5 billion of U.S. Government securities—\$10.5 billion more than at the end of 1957, \$3 billion more than a year ago.

#### **‘INCOME POLICIES’**

It is our money-creation, bond-buying, low-interest-rate, budget-deficit policy—in brief, our inflation—that has *caused* the very deficit in the balance of payments that the Administration wants to cure. And as long as these inflationary policies continue, any tax penalty or prohibition on foreign investment, “temporary” or permanent, is not going to cure the balance-of-payments deficit. In the long run any reduction in our foreign investment will tend to reduce our exports by a corresponding amount. It will reduce the dollars available to foreigners to buy our goods.

If the Administration persists in its inflationary policies, and tries to offset them with direct controls on foreign investment, it will only plunge deeper and deeper into controls. Dillon’s own words foreshadow this. He advocates “income policies to restrain upward pushes on the cost-price structure” caused by inflation. “Income policies,” a phrase ominously familiar in Europe, means controls of wages, salaries, profits, rents, interest, and other forms of income. It means moving toward a regimented economy.

And all because the Administration clings to the exploded Keynesian assumption that a perpetual creeping inflation—caused by chronic budget deficits, ever-increasing money supplies, and perpetual low interest rates—is necessary to full employment. It is neither

necessary nor sufficient. What is indispensable, however, is a coordination of wages, costs, and prices achieved through a restoration of real freedom of markets. ☸

## **Dread of a Surplus**

July 20, 1964

The last fiscal year ended on June 30 with a deficit of about \$8.8 billion. This was more than the entire amount spent by Franklin D. Roosevelt in any fiscal year till 1939. It will be followed by a deficit in the current fiscal year officially estimated at \$5.8 billion (and it will probably be much larger). The two deficits taken together will be the biggest for any two-year period in peacetime.

Yet no one showed any particular concern about this. *The New York Times* report hailed it as a great achievement. “The deficits in the last three years, while believed to have spurred the economy, have clearly not been inflationary.”

Most of the comment, indeed, has been to the effect that the deficit has not merely been harmless, but beneficial. And this reflects the present Administration’s own underlying fiscal philosophy, which is that a budget balance should be attempted only when the economy is at the level of “full employment.” This it defines as unemployment of 4 percent or less of the labor force. The President’s economic advisers have often expressed their conviction that previous efforts to balance the budget when the economy was operating with idle plant and idle labor only prolonged and increased unemployment.

Because of this fiscal philosophy the present Administration does not expect to see the budget balanced until the fiscal year 1967, which ends three years from now.

#### **WHY BALANCE EVER?**

But if the Administration’s economic assumptions are correct, why balance the budget even then—or at any time? If the country is enjoying full employment, as a result of deficit spending, why needlessly endanger that prosperity by returning to a budget balance?

We can be sure that, if ever the blessed full-employment goal were achieved, this argument would be put forward. And it is hard to see how it could be politically resisted. In fact, there are already commentators who contend that the government cannot afford ever again to run a surplus, and that balanced budgets are “economic suicide.”



It is instructive to recall the series of rationalizations that have brought us to this point. At first it was argued that a balanced budget was harmful only in “bad” years. The necessity of balancing the budget was accepted, but it should be only a “cyclical balance” over a series of years. But the cyclical theorists never revealed how long their cycle was, or how they or anyone else could know at any time just where we were in a cycle. If an average cycle is six years, say, then to offset the expected cumulative three-year budget deficit of \$21 billion at the end of this fiscal year there would have to be an average \$7 billion surplus in each of the next three years. The professed cyclical balancers would be appalled at such a prospect.

### 34 YEARS, 28 DEFICITS

So their theory is now that we should always run a budget deficit as long as there is any unemployment. And though we have already run 28 deficits in the last 34 years, they deplore only the six surpluses.

What will be the result if their theories continue to be followed? It was crushingly demonstrated in the '30s that even heavy uninterrupted deficits cannot cure mass unemployment. But more deficits can and must lead to further increase in the national debt, further increase in the money supply, a further rise of prices, and a further depreciation of the dollar. The purchasing power of the dollar has already been reduced 63 percent since 1933 and 43 percent since 1945.

It is true that in the last ten years the dollar has depreciated “only” 12 percent. But this result looks good only in comparison with the dreadful international record. The New York First National City Bank's annual review of comparative rates of depreciation shows that in the last ten years the German mark has lost 18 percent of its purchasing power, the British pound 23 percent, the Italian lira 25 percent, the French franc 34 percent, and the Argentine, Brazilian, Chilean, and Bolivian currencies respectively 91, 94, 95, and 97 percent.

Whether the deficits are “planned” or unplanned, the result is always the same. ❁

## The Issue of Statism

July 27, 1964

In the preface to his new book, *The Republican Opportunity in 1964* (Duell, Sloan and Pearce, 148 pages, 95 cents), my colleague Raymond Moley, after explaining how in recent years the terms *conservative* and *liberal* have both been torn from their original meaning to describe the precise opposite of what they

meant to our forefathers, offers his own description of the present American “liberal” in the modern sense:

“The liberal favors a generous extension of Federal power in areas that have hitherto been the responsibility of the states, the communities, and private organized effort; he believes in and supports more intervention of governments, especially the Federal government, in economic life, even to the extent of setting up government-owned and government-operated businesses; he favors a huge expansion of federally supported personal-welfare programs; he would undertake Federal expenditures on national-resource development, urban reconstruction, and area development. And he justifies the great enlargement of Federal expenditures involved in these programs on the ground that such expenditures promote economic growth. In the face of large deficits there has been added to the liberal's economic philosophy the concept of deliberately planned deficits in anticipation of larger revenues in future years.”

### 440 NEW LAWS A YEAR

It struck me how accurately this describes the philosophy and attitude of President Johnson and the Democratic “liberals” in the present Congress. This was illustrated a couple of weeks ago when it was disclosed that the President, in the belief that the passage of the Civil Rights Act had “opened the way to a new creative period” (as one news dispatch put it) in which the government can tackle new domestic problems, had convened a group of special committees, drawn largely from the academic community, to draft recommendations for future legislative and governmental action.

In other words, the President is sure we need still more laws, and if he doesn't know exactly what they ought to be, he appoints committees to think them up. And these new laws are to be piled on the 800 or so laws that each Congress passes. It passed 4,399 public laws in the last ten years.

What are new laws? They fall into two main categories. First are those that revise previous laws. This implies that Congress made mistakes in the previous laws that the new laws supplant. If, at a moderate estimate, each new or old law contains an average of ten provisions, this means that in every hundred such new laws Congress passes in a session, it may be correcting as many as a thousand previous mistakes. It also implies that it is constantly changing the rules under which people act, so that they cannot launch on new businesses or other long-term enterprises with any assurance that the rules are not going to be changed on them.



### A CLEAR CHOICE

The second category of new laws are those that deal with activities not previously covered by law. This means that the government is compelling people to do something or refrain from doing something that they were not previously compelled to do or refrain from doing. In other words, the individual's liberties are restricted in still another direction.

Congress has become a mass-production factory for legislation, turning out an average of 440 new laws every year. And yet it is continually being prodded by Presidents and in the press for "do-nothingism." "Progress" and a "creative period," we are given to understand, consist in the passage of still more hundreds of new laws, or the appropriation of still greater sums to be taken from A and handed to B.

Raymond Moley defines "conservatism" in his book as meaning "a halt in the expansion of government in domestic life and, above all, a reduction in size and scope of the Federal establishment."

This is what Barry Goldwater stands for, and it is, in the main (with some exceptions), the philosophy that the new Republican platform expounds. For the first time in many years we may witness a Presidential election offering the voters a clear choice of contrasting governmental philosophies. ☸

## Words against Words

August 3, 1964

Barry Goldwater made a tactical blunder in his acceptance speech, but it is not difficult to see how he fell into it. His opponents, both in the Democratic and the Republican parties, have been calling him and his supporters "extremists," and calling themselves—especially those that represented the extreme left wing of the Republican Party—"moderates." Goldwater, in an unthinking moment, accepted these labels and tried to turn them against his opponents: "I would remind you that extremism in the defense of liberty is no vice . . . [and] moderation in the pursuit of justice is no virtue!" The storm broke; and Rockefeller revenged his defeat by instantly finding these words "dangerous, irresponsible, and frightening."

Now "extremist" and "moderate" are both rhetorical labels, and Goldwater would have been justified in pointing out that the former is not necessarily synonymous with evil or the latter with good. Is it necessarily wrong to be extremely honest or extremely fair? Is it necessarily praiseworthy to be only a moderate liar or a moderate embezzler?

### THE ART OF POLITICS

But linguistic analysis does not pay off politically. Politics is conducted with emotionally loaded catchwords. The trick is to apply the approbatory ones to your own side and the derogatory ones to your opponents. Thus the "liberals" are having a field day with "extremist" and "moderate." A columnist on an outstanding newspaper, for example, solemnly praises Mr. Johnson's \$8.3 billion deficit for 1964 and his planned future deficits as "moderate" fiscal policy, and dismisses the advocates of balanced budgets as "extremists"!

Goldwater's appropriate response would have been to repudiate the label of "extremist" as applied to his own position and "moderate" as conferred by his opponents on themselves, and insist that his position is the moderate one and theirs the extreme one.

The art of politics consists in large part in taking over for oneself any label that has acquired prestige and pinning disparaging labels on one's opponents. This sometimes results in a reversal of traditional labels, and as words are the counters of thought, it has deeply confused and perverted political and economic thinking. In the United States today, for example, the word "liberal" has been torn from its original meaning and designates exactly the opposite of what it meant in nineteenth-century France and England and still means on the European continent.

### TRUE LIBERALISM

The true liberal tradition is the tradition founded and developed by such figures as Hume, Adam Smith, Jefferson, de Tocqueville, Cobden, Mill, Macaulay, Gladstone, and Lord Acton. They stood for limited government, decentralization, checks and balances; freedom of trade, production, and markets; low taxes with low spending and balanced budgets; the integrity of the currency, and non-inflation. They were against excessive government intervention; against statism and paternalism; against the piling up of new laws, compulsions, prohibitions. In brief, they believed in personal liberty. Liberal and liberty come from the same root.

When the statist and paternalists appropriated the word "liberal" for themselves, the original liberals allowed them to do it, and so were forced to call themselves first "libertarians" and then "conservatives."

Years earlier, they allowed Karl Marx to pull a similar trick on them. About six years after the publication of *The Communist Manifesto*, Marx and his followers coined the smear word "capitalism" to convey the implication that the system of free markets, private property, and economic liberty was a system imposed on the world by the capitalists and for the capitalists. That implication still sticks to the word. It explains why

defenses of “capitalism” under that name are infrequent and apologetic.

The battle of catchwords is unlikely to be abandoned in our time, let alone in the present campaign. But we are more likely to reach sensible solutions of our problems by using words in their traditional descriptive sense, rather than emotively as weapons. Is it too much to hope that at least the leaders in the coming debate will recognize this? ❁

## That ‘Fiscal Revolution’

August 10, 1964

The Republican Platform points out that the Democratic Administration has “burdened this nation with four unbalanced budgets in a row, creating deficits totaling \$26 billion, with still more debt to come, reflecting a rate of sustained deficit spending unmatched in peacetime.” And the platform goes on to pledge a reduction of not less than \$5 billion in Federal spending and “an end to chronic financing, proudly reaffirming our belief in a balanced budget.”

It is true that this does not go as far as the Democratic Platform on which Franklin D. Roosevelt was elected in 1932, which promised “a budget annually balanced,” but some people are alarmed because the Republicans mentioned a balanced budget at all. In doing so, Edwin L. Dale, Jr. contends in *The New York Times* (July 14), they “have rejected the fiscal revolution of the 1960s. They have done so even though, so far at least, the revolution seems to be proving a smashing success.”

“The revolution,” Dale goes on, “is quite simply a rejection of the desirability of a balanced budget until such a time as the economic boom achieves full employment.” And though the Administration has not “trumpeted” this “revolution,” it has in fact “begun to use the Federal budget as an economic weapon in the spirit of the late Lord Keynes, with a result that budget balance has been purposely postponed.”

To describe planned deficits as revolutionary is like describing intentional profligacy or irresponsibility as revolutionary. In the history of government, deficits are older than surpluses, and probably more frequent.

### OLD AS JOHN LAW

The only thing that could conceivably be called new is the praise and glorification of deficits and paper money, but even this can be traced back two and a half centuries to the days of John Law.

The records of the past do not support the theory that deficits cure unemployment. In each of the ten

years from 1931 to 1940 inclusive, the Federal government ran a deficit averaging 3.6 percent of the gross national product. During those ten years there was average unemployment of 18.6 percent of the labor force. The same percentage of GNP and of the labor force today would mean deficits averaging \$21 billion a year combined with more than 14 million annual unemployed.

All prolonged unemployment is the result of some discoordination in prices and wages. The champions of planned deficits assume that it is impossible to resist excessive union wage demands, and that the only way to restore or maintain full employment is to keep injecting more monetary “purchasing power” into the economy to make the higher wages payable. Under certain conditions, such as those that have been prevailing in recent months, a deficit increased or continued by tax reduction can temporarily bring prosperity and more employment.

### SHORTSIGHTED

But advocacy of prosperity through deficits is advocacy of a shortrun policy—one might also say, of a shortsighted policy. The advocates do not ask themselves how long this policy can be kept up and what its long-run consequences must be. These long-run consequences are plain to anyone who cares to look for them. We can see them in the inflations in Europe today, especially in the inflationary crisis in Italy. We can find an extreme example in Brazil, where the new regime is in trouble because of the 40 percent rise in living costs in the first six months of this year (on top of an 80 percent rise last year), accompanied by signs of a recession and rising unemployment. The new regime, dispatches report, is trying “to reduce the government’s operating deficit, regarded as the main cause of the inflation.”

No doubt our present deficit prosperity can be kept going quite successfully until the election and even beyond. But anyone who thinks that there will be no unpleasant aftereffects should recall: (1) that our cost of living has gone up 72 percent *since* the end of World War II in 1945; and (2) that our cumulative balance-of-payments deficit has been wholly the result of our government deficits and inflation since 1957, and that further inflation can only make the problem worse. ❁

## Hoover as Scapegoat

August 17, 1964

In his brilliant and absorbing biography of Herbert Hoover, published on Aug. 10 to celebrate the former

President's 90th birthday, Eugene Lyons is obliged to refer again and again to the incredible smear campaign launched against Hoover in the early months of his Administration and continued long after his exit from public office.

The campaign, under the paid direction of Charlie Michelson, was enormously successful. In his autobiography, Michelson afterward alluded to "the gloomy occupant of the White House whom we referred to as the author of the Depression." The smear stuck. "The Hoover Depression" became an established phrase. So did "Hoover bread lines" and "Hoovervilles." The myth got firmly established for a generation that Hoover had thrown the country into a major depression and that Franklin Roosevelt had bailed us out.

### THE DOUBLE MYTH

The facts support neither the first nor second half of the myth. The causes of the collapse and world depression that started in October 1929, go back years before Herbert Hoover assumed the Presidency. They are complex. But they can be summarized as cheap-money policies, credit expansion, inflation. And Hoover was among the earliest to combat such policies. In 1925, as Secretary of Commerce, he warned in a letter to one of the Federal Reserve governors against "inflation with inevitable collapse which will bring the greatest calamities upon our farmers, our workers, and legitimate businessmen." In a New Year's statement for 1926 he warned against "real estate and stock speculation . . . with inevitable inflation." One member of the Federal Reserve Board, Adolph C. Miller, who opposed the cheap-money obsessions of his colleagues, testified in an interview published in the magazine *Sphere* in July 1935:

"The Board knew that Mr. Hoover, from 1926 on, had been protesting that the money policy of the Reserve System was certain to bring about disaster and calamity. Mr. Hoover before and after he took office was struggling desperately to curb credit extravagance. . . . The record will show that he became the victim of a policy that was anathema to him the whole time it was in operation."

When the Depression started, Hoover made Herculean efforts to stem it. The most fantastic myth of all was that he "did nothing." A far more plausible charge is that he did too much. True, he made errors. But they were not those for which he is popularly blamed.

### MAINTAINING WAGES

The most serious error, in my estimation, was to call together the leaders in business in November 1929, a month after the stock-market break began, and urge upon them the policies of not cutting prices, not cutting

wages, and increasing capital outlay. When there has been a collapse in confidence, in demand, and in the money-and-credit supply, there must be some downward adjustment in prices and wages if sales, output, and employment are to be sustained. When, under such circumstances, prices and wages are inflexible in a downward direction, the result can only be spreading unemployment.

But the doctrine of maintaining or even increasing money wage rates, to "increase purchasing power," has now become New Deal, Fair Deal, Keynesian, Hellerious gospel.

But the great "error" for which the New Dealers, Keynesians, Hellerites, and Fiscal Revolutionists blame Hoover is trying (unsuccessfully) to balance the budget. I doubt that this was an error. In any case none of Hoover's opponents at the time thought so. On the contrary, it was the deficits and the "spending" that Franklin Roosevelt denounced. The Democratic platform pledged a budget "annually balanced."

It is constantly forgotten that the worst disasters in the Hoover Administration came in the last four months, after his election defeat and before FDR took office, when Hoover was powerless and FDR refused to deny rumors that he meant to take the country off the gold standard.

The final myth is that Roosevelt stopped the Depression. In his first two terms, chronic deficits were combined with massive unemployment. Only our entrance into World War II "solved" the problem. ☸

## The Poverty Package

August 24, 1964

The anti-poverty law—or the Economic Opportunity Act of 1964, to use its official title—is primarily a Democratic campaign document and a vote-buying device. It is designed to give the impression that for the first time in our history the Federal government has become aware of the existence of poverty and is doing something about it. Actually we have been piling one "anti-poverty" program on top of another since the New Deal began 30 years ago.

The excellent Republican minority report on the bill to the House listed 42 individual programs "designed to combat and overcome the causes of poverty" already in existence. These programs cost a total of \$31.8 billion in the fiscal year 1964. According to the Social Security Bulletin for November 1963, a total of \$66.5 billion was spent by all levels of government for "social



welfare” purposes in 1962. During the same year, an additional \$33.5 billion was spent by private organizations for the same purpose. Compared with this total of \$100 billion, the new law’s appropriation of just under \$1 billion makes it a merely token (and in no sense new) “war on poverty.”

### DUPLICATION

The official title is calculated to give the impression that the new law is just a way of helping people to help themselves. The measure in detail, however, reads like the implementation of Mr. Johnson’s statement in January: “We are going to try to take all of the money that we think is unnecessarily being spent and take it from the ‘haves’ and give it to the ‘have nots’ that need it so much.”

The new law is hard to describe briefly because it is a conglomeration of unrelated programs. The House minority report calls it “a hastily assembled package of odd legislative retreads and rejects, interspersed with a sprinkling of old, unsuccessful experiments and a plagiarized assortment of existing programs.”

Nearly all of the “new” programs duplicate or compete with existing Federal programs. The so-called “Job Corps” providing for work camps will cost \$190 million in the first year for only 40,000 enrollees, or \$4,700 per enrollee. The first-year cost of the “work-training” program is another \$150 million. Both programs heavily overlap the 1963 Vocational Education Act and the expanded Manpower Act. The \$72.5 million “work-study” program will give more assistance to the very same college students now being aided by the massive student-loan program under the National Defense Education Act. Direct loans to low-income farm families duplicate a huge existing Farmers Home Administration program. Loans under Title IV would duplicate what the Small Business Administration is already doing. And so on.

### WELFARE STATISM

The first year’s price tag on this new measure—\$947.5 million—is relatively small as current spending goes. But it will carry us a giant step deeper into a paternalistic welfare state. Its ultimate effect will be to create a good deal more poverty than it cures. We can be sure that its cost will increase each year. This cost, if paid for out of bigger taxes, will increase the burdens on private enterprise and the deterrents to production. If it is added to the deficit, it will increase inflation, an invisible but destructive tax with its cruelest impact on the poor.

As the House minority report pointed out, no society in the history of the world has so effectively overcome the cruel grasp of poverty as has the United States.

In terms of a “war against poverty,” the whole history of America has been a history of sustained and spectacular accomplishment. In 1929 (using 1962 dollars as a standard), more than 50 percent of American families had an annual income of less than \$3,000. By 1947 this figure had fallen to 30 percent, and by 1962 to 21 percent. In this same period, American families having an annual income of \$6,000 or more rose from 15 percent to 48 percent. Americans earn more, own more, consume more, and live better than any other people on earth.

And we have achieved this result, not by government “anti-poverty” programs, of which we have had proportionately less than most nations, but by our system of free, private, competitive enterprise, which provides maximum incentives to production. ☸

## Socialism and Famine

August 31, 1964

India is suffering from high prices and a food shortage. Both have been brought about by the government’s own policies. For years it has indulged in monetary inflation, controls, state planning, socialism, and a forced industrialization that diverts capital and labor away from farming.

Alarmed by the food riots, the government is, taking drastic measures. Most of them are exactly the wrong measures. It has put ceilings on the price of rice, and announced, price controls on matches, oil, kerosene, sugar, and vegetable oils. This is precisely the step that will do most to discourage production of these necessities. When there is a shortage of any product the cure is high prices, not low prices. In a free market, without controls, relatively high prices for a product signal a shortage of that product, and give maximum incentives to producers and importers to relieve the shortage.

The Indian Government, looking for scapegoats, has blamed “speculators” and “hoarders,” and announced the imposition of strict controls on the purchase, sale, storage, and transportation of grains. But speculators and hoarders, when they really act intelligently in their own interest, perform a public service. If they are right in thinking that if they hold back now they will get a higher price later, this means that they are conserving supplies now to relieve an even greater future scarcity. Unless they sell at the point of maximum scarcity, they miss their best market and merely defeat themselves.



## RUSSIA VS. INDIA

But the Indian Government, distrusting the whole private-market mechanism, is setting up a government grain corporation to do the food importing and trading. The supreme irony is that just as the Indian Government has announced this new imitation of Russia, Russia has decided to move in precisely the opposite direction. Early in August, Premier Khrushchev proposed that potato and vegetable farms sell their produce directly through their own city stores instead of marketing it through the government trade network. The advantage of such a system, he explained, is that the consumer would be able to reject poor quality produce in one store in favor of higher-quality produce offered by another farm's store. Because of the unreliable supply system of the state trade channels, and the low quality of the produce offered, Soviet city workers as well as peasants have in recent years been cultivating their own garden plots. In 1962, 70 percent of the nation's potato crop and 42 percent of the vegetables were produced on these private plots.

## PRIVATE PROPERTY

Until now, the net income of the collective farms has been divided among the members on the basis of the work done, computed in workday units. This is to be replaced by a system of payments linked directly to quantity and quality of output. As Khrushchev summed it up in a question he asked a tractor driver in a wheat field: "How would you like it if you were assigned a given plot of land where you would be responsible for all operations, plowing, planting, cultivating, and harvesting, and you would be paid on the basis of the crop produced?"

Marvelous idea! The equivalent of a private lease! It is, in fact, a third of the way back—or forward—to private property. Only two more steps would be necessary to complete the reform. The next would be to allow the individual farmer *permanent* rights to a plot. This would give him the incentive to conserve and build up the soil to improve the buildings, etc. The final step would be to give each farmer the right to buy or sell plots. The successful farmers would then acquire more plots from the unsuccessful, and production would drift more and more into the hands of the most efficient and productive—thus constantly increasing efficiency and production.

The Chinese Communists are quite right when they accuse Khrushchev of flirting with capitalism. If he continues in this direction, while we continue our drift into socialism, Russia may indeed one day outproduce us. Meanwhile socialist India and Communist Russia must import food from capitalist America to pull them through. ☸

## World Money Reform

September 7, 1964

After ten months of study, the monetary experts of the ten leading industrial nations of the free world have come up with their report on what should be done about the world's currencies. At the same time, the International Monetary Fund, with 102 national members, has brought out its own recommendations.

The two reports, in substantial agreement, are what might have been expected. They reject all "extreme" proposals, such as the creation of a new international paper money issued by the IMF, or turning the IMF into a super-central bank that could create reserves internationally much as the Federal Reserve does domestically. Nevertheless, they propose that the IMF be beefed up substantially and quickly, and that this be done in some way that won't cause a heavy drain on the U.S. gold stock.

The main proposal is that the resources of the Monetary Fund be raised by a "moderate general increase"—say, 20 to 30 percent—in the quotas of the member nations. If this boost is adopted, it will be on top of a 50 percent increase in 1959.

What lies behind this proposal (and behind the far more inflationary proposals that the "group of ten" rejected) is the fear of a "shortage of international liquidity"—the fear that, unless the new gold produced annually is progressively supplemented by new money and credit, there will not be enough to keep pace with and to finance the growing volume of world trade, and that a shortage of "liquidity" would force the world into deflation and unemployment.

## MISPLACED FEARS

These fears appear groundless. Accepting the Monetary Fund's own estimates, let us suppose that world trade rises by at least 4 percent a year in the next decade, while gold holdings (and even the credit based on them) do not rise more than 2½ percent a year. What would happen?

There would, of course, tend to be a gradual lowering of world prices of, say, about 1½ percent a year. Would that be something to dread? Would it wipe out profit margins? Would it precipitate heavy unemployment? There is no reason to suppose so. Prices would tend somewhat lower simply because the supply of goods was increasing faster than the supply of gold. As, in all probability, real and money costs of production would be falling at about the same rate as final prices, there would not necessarily be any real shrinkage of profit margins, or any reason for increased unemployment.

Everyone seems to have forgotten that balanced economic growth can take place quite successfully even with moderately falling prices. An outstanding example of prosperity with falling prices occurred between 1925 and 1929, when full industrial activity was maintained with an average drop in wholesale prices of more than 2 percent a year.

### THE DANGER IS INFLATION

The real monetary danger that this country and the world face today is not “shortage of liquidity” or deflation, but a continuance and acceleration of the inflation that has been raging since the end of World War II. This world inflation has coexisted with the life of the Monetary Fund. Of the 48 or so members of the IMF in 1949, practically all except the United States devalued their currencies that year following the devaluation of the British pound. Of the 102 present members of the IMF, the great majority have either devalued since they joined, or allowed their currencies to fall in value since then as compared with the dollar. And the dollar itself, since 1945, has lost 42 percent in purchasing power. In the last ten years alone the German mark has lost 18 percent of its purchasing power, the British pound 23 percent, the Italian lira 25 percent, the French franc 34 percent, and leading South American currencies from 91 to 97 percent.

This is no mere coincidence. It is largely the result of the IMF system itself, which was set up at Bretton Woods by Lord Keynes and Harry Dexter White expressly to allow nations to escape from the discipline of a real gold standard. And all the ingenuity of today’s monetary “reformers” goes into concocting still more devices to enable world inflation to go on without any government having to allow its citizens to convert its depreciating money into hard gold. ❁

## Big Brother State

September 14, 1964

Throughout the Democratic platform runs the assumption that practically all earthly problems can be solved by more laws, more government spending, and more government power. The preamble lists the “achievements” of the Kennedy-Johnson Administration—i.e., the new laws passed, the new appropriations made, and the new Federal agencies, bureaus, and divisions created on top of the 2,000 or more already in existence.

The list is formidable: the Area Redevelopment Administration; the Economic Opportunity Act of 1964; the Appalachian Redevelopment Act; the Equal

Pay Act of 1963; the Manpower Development and Training Act of 1962; the 1961 amendments to the Fair Labor Standards Act; \$1 billion of new loans made by the Rural Electrification Administration; more than \$1 billion in new loans made since January 1961 by the Small Business Administration; the Community Health Services and Facilities Act of 1961; the Mental Retardation Facilities and Community Mental Health Construction Act of 1963; the Social Security Act amendments of 1961 (still further broadening benefits); the 1961 public-assistance increases; the Higher Education Facilities Act of 1963; the Health Professions Educational Assistance Act of 1963; the Vocational Education Act of 1963; 1963 legislation increasing authorization for loans to college students; the Housing Act of 1961; the Kefauver-Harris drug amendments of 1962; higher disability payments to veterans. And more.

### GOVERNMENT UNLIMITED

Practically all these measures, whatever their individual merits, mean still more spending, still more controls over the economy, a still bigger entrenched bureaucracy, still further steps toward almost unlimited government intervention and government power. And what the Democratic platform promises is still more of the same: compulsory medicare, a bigger social-security program, still more unemployment insurance, government training and retraining programs, still more “commodity programs to strengthen the farm-income structure,” a bigger housing program, more handouts for urban renewal and for “Appalachia.” Finally, the platform promises “to carry the war on poverty forward as a total war.”

The spending programs are to be combined with still greater government controls. The minimum-wage level and coverage are to be increased. Compulsory overtime payments are to be increased. The one-sided immunities and special privileges now enjoyed by labor unions are to be increased.

### THE NEW MAGIC

The motto of the Democratic platform, in brief, is “Let us continue.” Let us continue to pile up more laws, more compulsions, more agencies, more bureaucrats, more power, more spending, and we will bring you ever closer to an earthly paradise. Or to the Orwellian nightmare of 1984? The platform blandly forgets that government creates nothing, makes nothing, adds nothing, but can merely deflect production from one channel to another, or seize more from Peter to pay more to Paul.

But the Johnson Administration and its fiscal advisers and apologists are trying to convince us that they have discovered a new magic that enables us to

eat our cake and still have it—to pay more and more to Paul while taking less and less from Peter. On top of this year's tax cut there will be more tax cuts. We will continue to pile more deficits on top of the 28 deficits, in the last 34 years. But this time they will be planned deficits, "purposeful" deficits, and will bring us the full employment that they have failed to bring in the past.

This is a complete abandonment of even the pretense of fiscal responsibility. In 1960, the Democratic platform said: "Responsible fiscal policy requires surpluses in good times to more than offset the deficits which may occur in recessions, in order to reduce the national debt over the long run." But all this is now forgotten, and all we are now promised is "a balanced budget in a balanced economy." This means a budget balanced only in years of "full employment." We have had only nine such years (six of them wartime years) in the last 35. The platform pledge is a pledge to continue inflation. ❁

## Results of Antitrust

September 21, 1964

For three-quarters of a century the great majority of lawyers, politicians, and economists have praised our antitrust laws. But in recent years these laws, and especially Federal prosecutions under them, have greatly increased in number. Their ambiguities, vagueness, contradictions, and possibly sweeping application have become clearer, and responsible commentators have begun to question their wisdom and probable effects.

The August *Survey* of the Morgan Guaranty Trust Co. of New York bluntly asks whether the present jumble of antitrust laws, and particularly recent Supreme Court decisions, will in fact promote free competitive enterprise in the United States. "In one momentous year," it declared—"from June 17, 1963, to June 22, 1964—the Supreme Court of the United States rewrote the rule book governing mergers and acquisitions in American business. Six key decisions were handed down. . . . They either invalidated or cast a shadow of illegality upon mergers that previously had been approved by lower courts and, in some instances, by regulatory agencies as well."

### A FLAT GAMBLE

After analyzing these six key decisions, and the five leading antitrust acts under which they were made, the bank concludes: "The 'do's' and 'don'ts' of antitrust are largely what the Supreme Court says they are. The latitude the Court assumes in interpreting and applying

the antitrust laws is immense. The provisions of the Sherman Act, for example, have been characterized as having the breadth and generality of the Constitution itself. Oversimplified, this means that the law can be applied or interpreted in different ways as the Court's rationale in a given case may demand."

As a result, any decision "to proceed with a significant merger involves a flat gamble on whether the government will sue. In weighing the odds, a company's owners or directors will hardly fail to recognize an implication inherent in recent antitrust history. This is that really sound mergers from the businessman's point of view—those that will strengthen his company in its competitive struggle and enlarge its base of operations—are the very ones most likely to be contested by the Justice Department and outlawed by the courts. In consequence, it is likely that fewer and fewer major mergers will be undertaken."

Sylvester Petro, professor of law at New York University School of Law, discussed the problem in an article in the July *Freeman* magazine (published at Irvington, N.Y.). He showed that, if current antitrust policies had been applied consistently in the past 75 years, such firms as General Motors, Chrysler, U.S. Steel, and General Electric would probably not be in existence today.

### DOUBLE STANDARD

What struck him was the contrast between the way the Federal government treats businessmen under the antitrust laws and the way it treats other groups for doing the same thing: "While sending some people to jail for agreeing on prices, it considers nationwide price-fixing agreements laudable if exacted by trade unions; it visits penalties on farmers for departing from the prodigious price-fixing schemes known as our agricultural policy; it forces uniform prices on airlines and other participants in the transport industry; and finally, as we have seen, it forbids individual businesses to vary their prices downward at will." He might have added: it conspires in international price-boosting through fixation of export quotas on coffee.

It is hardly necessary to point out that if the antitrust laws and decisions were strictly applied to the labor unions they could not function. Collective bargaining itself would have to be considered unlawful as a combination in restraint of trade. It involves "collective" price-setting.

Professor Petro believes in the equal application of the same law to all. But rather than apply the anti trust laws to unions, which he thinks both impractical and undesirable, he suggests that our antitrust laws themselves need to be seriously re-examined to see whether



they are not, in fact, an actual threat to the vigorous growth of a free competitive enterprise system. ❁

## How to Beat Inflation

September 28, 1964

I am frequently asked by correspondents what they can do personally to protect themselves against inflation. The question is difficult to answer, either specifically, by giving tips on individual stocks (which I would not dare to do), or even in general terms.

The nub of the problem is that inflation forces everyone to become a gambler. If a man puts his money in a savings bank or in a “safe” bond, and the inflation continues, he is a certain loser. He gets back the face value of his savings or his bonds in dollars, but the dollar will not buy as much as the dollars he saved or invested. Even since the end of World War II, in 1945, consumer prices have risen 72 percent, which means the purchasing power of the dollar has shrunk 42 percent since then.

The problem for the individual is that he can never be certain how much further the inflation is going to go or at what rate. Many people assume that the rate of future inflation can be calculated from the past rate of inflation. Even if this assumption were sound, which it is not, endless disputes are possible even about the rate of past inflation.

### THE TAKE-OFF DATE

The rate since when? The take-off date has to be arbitrarily selected. As compared with ten years ago (1954), consumer prices have gone up 15 percent, which makes the rate of inflation, as measured by price changes, 1.5 percentage points a year. As compared with 1944, or twenty years ago, consumer prices have gone up 76 percent, or 3.8 percentage points a year. As compared with 1934, or 30 years ago, consumer prices have gone up 132 percent, or 4.4 percentage points a year.

Even if, by some amazing clairvoyance, you knew what the average rate of inflation was going to be in the next year or decade—i.e., how much the consumer index was going to rise—you would not necessarily know how this was going to affect the particular asset you held or were thinking of buying, whether General Motors shares, a house, or a Picasso.

A further problem would be to know how much the past inflation, or the expected future inflation, had already been reflected in, or “discounted” by, the present price of the asset you held or thought of buying.

And this brings us to the centrally important point that it is impossible for everyone to protect himself

against the ravages of inflation. Those who gain must do so at the expense of others who lose. Those who are shrewd enough or lucky enough to buy stocks or other assets before they have risen in price to reflect the inflation, must gain at the expense of those who buy later; and still more at the expense of those who do not buy at all, but hold only money; and still more at the expense of those who buy at the top, when past or further inflation has been overdiscounted.

### UNEVEN IMPACT

Every day during an inflation, schemes are put forward designed to protect everybody against it. All of them rest on delusion. The most popular is that of insisting that all wages and salaries be raised in direct proportion with the rise in the cost-of-living index. If this could work, it would benefit wage and salary receivers at the expense of all those dependent on other types of income. But it cannot work except on a limited and selective scale.

For inflation, if it operates in a free or relatively free market, always affects the prices of different commodities and services unequally. Let us assume, for simplification, that it sends up the prices of half of all commodities 20 percent and the rest not at all. Then the average price rise is 10 percent. The workers in the favored industries might be able to secure wage rises much greater than this. But if the unfavored industries were forced to pay a wage increase of 10 percent, most of them could not afford it. The result would be wholesale unemployment in those industries. If, in order to make the higher wage rates payable, the government increased the money-and-credit supply still further, the inflation would soon be off to an accelerating spiral. This is exactly how this device worked in the German inflation of 1923.

There is only one way to stop the injustices of an inflation. Stop the inflation itself. ❁

## The Consumptionists

October 5, 1964

The Italian economist Maffeo Pantaleoni (1857–1924) used to maintain that there were really only two schools of economists—the good ones and the bad ones. The division was valid enough but unhelpful on specific issues. A young American economist, George Reisman, has now come up with another division of economists into just two groups, but one that throws real light on the chief economic controversies of our time.



In the October issue of *The Freeman*, published by the Foundation for Economic Education, Inc., at Irvington, N.Y., he divides all present-day economists into Productionists and Consumptionists.

With the exception of a few isolated mavericks, nearly all economists since the days of Adam Smith until say, 1929, identified the fundamental problem of economic life as production. Man needed wealth. He needed goods and services not only for the amenities of life but to keep alive at all. His problem was how to produce the goods and services to satisfy these needs and desires. The classical economists, therefore, took the desire to consume for granted, and focused on the means by which production might be increased.

### NO PROBLEM OF 'JOBS'

In the twentieth century, economists have returned to the directly opposite view—which happens to be the view that was held by the Mercantilists of the seventeenth century. Instead of the problem being how to keep expanding production in the face of a limitless desire for wealth resulting from the limitless possibilities of improvement in the satisfaction of man's needs, the problem is imagined to be how to expand the desire to consume so that consumption can keep up with production. The dominant theory today takes production for granted and focuses on the ways and means by which consumption may be increased. It proceeds as though the problem of economic life were not the production of wealth, but the production of consumption.

The "classical" economist, or productionist, realizes that there is no such thing as a problem of "creating jobs." There is a problem of creating remunerative jobs, but not just jobs.

At all times, the productionist holds, there is as much work to be done, as many potential jobs to be filled, as there are unsatisfied human desires which could be satisfied with a greater production of wealth. The use of more and better machinery does not cause unemployment. It merely allows men, to the extent that they do not prefer leisure, to produce more and so meet their needs more fully and with less effort.

### FEAR OF PRODUCTION

The consumptionist, on the other hand, regards every expansion of production as a threat to some portion of what is already being produced. He imagines that production is limited by the desire to consume. He fears that this desire may be deficient, and, therefore, that an expansion of production in any one segment of the economy must force a contraction of production elsewhere. He fears that the work performed by machines leaves less work to be performed by people, that the work performed by women leaves less work

to be performed by men, that the work performed by Negroes leaves less to be performed by whites, and that those who work overtime leave fewer jobs available for others.

The consumptionist, Reisman goes on to show, is driven by his basic premise into one fallacy after another. Because he imagines production to be limited by the desire to consume, rather than consumption being limited by the ability to produce, the consumptionist does not value wealth, but the absence of wealth. He is happy to find a scarcity of anything because to him it represents a large supply of unused consumer desire. He lives in constant dread of an absence of "investment outlets" or "investment opportunities." He dreads "hoarding." He regards everyone as a potential miser whose consumption demand has to be constantly whipped up. He is busy devising new schemes for the government "to supplement private demand" by spending more money—the increased expenditure to be financed by bigger deficits.

He is, in brief, a Keynesian, a New Dealer, a Fiscal Revolutionist, a self-styled "liberal" and, *mirabile dictu*, a "moderate." ❁

## The Irreversible State

October 12, 1964

LONDON—Whatever the outcome of its current election, Britain will continue to be at least a semi-socialist state. In the event of a Labor victory, this is of course beyond dispute. The Labor Party's manifesto insists on the panacea of "socialist planning." It is openly contemptuous of the free market: "At the root of Tory failure lies an outdated philosophy—their nostalgic belief that it is possible in the second half of the twentieth century to hark back to a nineteenth-century free-enterprise economy and a nineteenth-century unplanned society. . . . The role of government must inevitably increase."

The Labor manifesto goes on to explain how the party will plan practically every aspect of everybody's economic life. The national economic plan will decide how much each industry will be expected to produce, export, and invest and how many men it will be expected to employ. The government will "establish new industries." "Private monopoly in steel will be replaced by public ownership and control." A "national incomes policy" will decide who gets how much. All the social services—education, public housing, health care, old-age pensions—will be increased. Rents will be recontrolled. Interest rates for housing will be

lowered. Labor will increase the building of new houses. Unemployment benefits will be upped.

### SUBSIDIZED LEISURE

There is one concession to personal freedom: "It is not the job of the government to tell people how leisure should be used." But lest this sound too permissive, the manifesto insists that "the government has a duty to ensure that leisure facilities are provided." It will "give much more generous support to the Arts Council, the theatre, orchestras, concert halls, museums, and art galleries." It will even "encourage and support independent filmmakers both for the cinema and television."

Those Britons who would like a somewhat less paternalistic state get little comfort from the Liberals. The Liberal Party manifesto insists that "economic growth must become a major aim." To give that aim "top priority" a "Ministry of Expansion" must be set up. While both Laborites and Conservatives seem to agree that a 4 percent annual rate of growth would be the right target, the Liberals "would weigh up the implications and decide on a 4, 5, or 6 percent rate of growth." The Liberals too would have an "incomes policy," which would "make allowances for groups that would have been left behind." They would "set up Meat and Grain Commissions to manage the market for both home and imported produce," boost the existing government building program "to at least 500,000 homes a year," and increase social-security payments.

### LIP SERVICE

When one turns to the Conservative manifesto, one gets at least lip service, and sometimes even eloquent lip service, to the free market. "Competition and free choice are the customers' most effective safeguards." "Conservatives believe," says Sir Alec Douglas-Home, "that a centralized system of direction cramps the style of the British people. Only by trusting the individual with freedom and responsibility shall we gain the vitality to keep our country great." Ringing words. But how seriously do the Conservatives take them? True, they declare themselves "utterly opposed to any extension of nationalization, whether outright or piecemeal. We propose to complete the denationalization of steel." But there they stop. They do not propose to denationalize the railroads, or coal, or other industries under public ownership. They long ago lost their nerve on complete repeal of rent control. Now they make the positive pledge: "In the next Parliament we shall take no further steps to remove rent control." They too will boost unemployment benefits and old-age pensions. They too will have "an effective and fair incomes policy." They too will "give first priority to our policy of economic growth"

of 4 percent a year. They too have now embraced government economic planning.

Does the welfare state, once embarked upon, set up such powerful vested interests for its own preservation that it passes a point of no return? Does it become irreversible? ❁

## How New Is Inflation?

October 19, 1964

When the 88th Congress finally adjourned, a section of the press broke out in paeans of praise for its accomplishments. Typical was a "news" story on the front page of *The New York Times*, announcing that what was "likely to earn high ranking in history's catalogue of achievements" was the expiring Congress's action in "approving an \$11.5 billion tax cut despite rising budget deficits."

This, it seems, is precisely what is called for by "modern economic theory." This requires tax cuts, even in the face of huge deficits, "in times of sluggish economic activity and high unemployment." It has suddenly been discovered by economists, it appears, that "a tax cut, by giving families and business more money to spend, [would stimulate] demand for goods and services, thus increasing production and creating jobs . . . If the theory is valid, Congress has now embarked on a course that may be of vast importance in improving the country's living standards, both immediately and in the long run."

### FOLLY OF PRUDENCE

If the theory is valid, indeed, then all statesmen of the past, who thought they were acting prudently and responsibly in trying to avoid bankruptcy or inflation by keeping expenditures within revenues, were merely fools. For by withholding handouts from pressure groups, and insisting on keeping taxes high enough to pay for necessary expenditures, these people were not only creating unemployment and depression, but imperiling their own re-election. If the theory is true, then the politicians who vote huge handouts to pressure groups, and refuse to impose the taxes to pay for them, are not, as previously assumed, irresponsible demagogues, but public benefactors. The same actions that buy elections also confer economic blessings on the whole community.

If the theory is true, does it have any limits? And what are they? What would be wrong, for example, with doubling the amount of Federal expenditures and abolishing taxes entirely? Wouldn't this give families

and business still more money to spend, still further stimulate demand for goods and services, and still further increase production and jobs?

Alas, the practice is not new and the theory is neither new nor true. Budget deficits go back to time immemorial. The theory of deficits, paid for by printing more paper money, can be traced back to the very beginning of our history as a nation. The Continental Congress began its disastrous issues of paper money in 1775, because it was afraid to levy taxes. Peletiah Webster, writing in 1790, quotes a member of that Congress as saying: "Do you think, gentlemen, that I will consent to load my constituents with taxes, when we can send to our printer and get a wagon-load of money, one quire of which will pay for the whole?"

### PAST FAILURES

If the theory of the beneficence of deficits is new this year, why have we had 28 deficits in the last 34 years?

That deficits do not cure unemployment has been shown over and over again in the last half century. In each of the years from 1931 to 1940 inclusive, the Federal government ran a deficit averaging 3.6 percent of the gross national product. During those ten years there was average unemployment of 18.6 percent of the labor force. The same percentage of GNP and of the labor force today would mean that even deficits averaging \$22 billion a year could be accompanied by more than 14 million annually unemployed.

The inflation brought about by "planned" deficits (either through increased spending or tax cuts) can under special conditions, it is true, bring about a temporary increase in prosperity. There is no doubt that our present prosperity and reduction in unemployment owe a lot to recent tax reduction. (The employment record is nothing to brag about, however. Unemployment is still above 5 percent, compared with an *average* of 4.9 percent in the eight Eisenhower years.) But as soon as the new money in circulation begins to reflect itself in higher prices, and as soon as wage rates, under the stimulus of the automobile settlement, take off on a new round of rises, the present euphoria may give place to sober second thoughts about the unadulterated magic of deficit spending. ❁

## Why He Is Losing

October 26, 1964

On the basis of the polls, Barry Goldwater will not only be defeated by a landslide popular vote on Nov. 3 but

the Republican representation in Congress will be cut down substantially even from its present minority level.

It is instructive to look at the reasons why this result is probable.

1—The country is enjoying a period of unparalleled prosperity, which heavily favors the party in power.

2—Enormous prestige always surrounds the man who holds the office and title of President. His every word and action command publicity. In addition, President Johnson enjoys an almost unique advantage. In office less than a year, he has become the beneficiary of the Kennedy achievements without getting any blame for the Kennedy errors—in the Bay of Pigs, Berlin, Vietnam, or the steel-price episode.

3—In addition to the prestige of the office, there is the unparalleled power that the Presidency now commands, particularly when combined with party Congressional control. Unwelcome investigations into corruption can be blocked or broken off. A tremendous bureaucracy that owes its appointment or continuance in office to the President can be drawn upon to denounce all criticism. Part of this bureaucracy—e.g., the State and Defense Departments—has access to information unavailable to the opposition. These departments can say that the truth is so-and-so; that the opposition's charges are "irresponsible," and that it is not in the public interest that the issue raised should be publicly discussed at all. The challenger is seldom in position to make a convincing reply.

4—The greatest means of mass communication today, the radio and television, which depend on the Federal government for their licenses and their continuance, will tend, with whatever technical "neutrality," to be overwhelmingly on the side of the President and party in power.

5—When any party has been in power for four years, its flood of messages, speeches, press conferences, and laws establish an ideology that puts the main burden of proof on any opposing ideology. Vested interests are built up in all directions, from war contracts to social security.

6—There is a deep split in the Republican Party, partly caused by Governor Rockefeller's frustrated ambitions but mainly the result of a profound division of opinion between "conservatives" and "liberals."

7—Finally we come to the conduct of the campaign itself. Mr. Johnson is a political master, with an uncanny sense of the most effective act or phrase. At least until the Jenkins episode, he had not made a single major political error. Senator Goldwater, on the other hand, has been inept both in choosing issues and in stating



them. His positions on dealing with the Communists, on the U.N., on control of the nuclear bomb, on social security, have been grossly misrepresented. But he has been partly responsible for this misunderstanding by his own ambiguities and belated qualifications. He has been too often content with vague generalities. His attacks (and phrasing) have been haphazard. He has not seemed to understand the need for specifying, documenting, and nailing down the details of his case.

8—Above all, he has until now let the case on economic issues—the case for free enterprise, and against inflation, deficits, spending, the monster paternalistic state—practically go by default. In the Oct. 11 issue of *The New York Times Sunday Magazine*, Prof. Milton Friedman made a brilliant defense of what he assumed Senator Goldwater's economic philosophy to be. No similar clear and detailed statement has so far come in this campaign from speeches by the senator himself. Yet if the Johnson-Humphrey ticket and the Democrats in general win by the margins that now seem likely, the result is sure to be interpreted as a popular endorsement of more inflation, deficits, spending, paternalism, and more "wars on poverty."

Unless Barry Goldwater starts spelling out in detail, right now, the case against the Johnson-Humphrey fiscal, monetary, and economic policies—cheap money and chronic inflationary deficits that threaten the dollar, handouts to every pressure group—the prospect of an election result that will discourage these policies is not bright. ❀

## The Economic Issues

November 2, 1964

The economic issues are not the sole issues in this campaign, but they may in the long run prove far the most important.

Let us suppose that the polls are right and that the Johnson-Humphrey ticket is elected by a landslide. The result is sure to be interpreted as an endorsement of all the Johnson-Humphrey economic policies.

It will, of course, be considered an endorsement of the recent \$11.5 billion tax cut. But more than that, it will be interpreted as endorsing the *policy* of huge cuts in taxes even when the country is already facing a huge deficit and has experienced chronic deficits in the past. For the present tax cut, in connection with the spending program, will mean our 29th deficit in 35 years.

Businessmen who endorse the tax cut are taking a superficial and shortsighted view. A tax cut is sound and

desirable only when it still brings in enough revenue to meet expenditures. The present tax cut is deliberately inflationary. In the last half of this year the Federal government is pumping in \$12 billion more cash payments to the public than it is taking out in taxes. Of course this can bring about a temporary prosperity and "increase of purchasing power"—at the cost of overstimulating the economy and letting loose more inflation.

Deficit-financing and other inflationary policies can temporarily increase employment as long as wage costs do not rise as fast as demand or commodity prices. But the recent automobile wage settlements, far exceeding even the Administration's own wage "guideposts," seem likely to set off another round of wage rises that in turn threaten a profit-squeeze and unemployment or a further dose of inflation to keep employment up.

The Administration has favored increased welfare spending in all directions—expanded social security with medicare, high farm supports, high foreign aid, and a "war on poverty" that in its first year will add still another \$1 billion to the \$45 billion already being spent annually by cities, states, and the Federal government on various welfare programs. All this is going to make it more and more difficult to bring the budget under control.

Obviously the whole program must tend to prolong the deficit in the balance of payments and the international pressure on the dollar. But the Administration has shown no interest in removing the causes of this, but only in suppressing symptoms by imposing an interest-equalization tax on foreign securities and otherwise moving toward exchange controls.

The danger toward which we are drifting, in fact, is that the policies being followed by the Administration will lead to a runaway inflationary boom, that the Administration will not dare to halt these policies, but in desperation will impose an ever-widening network of economic controls which will strangle healthy economic growth.

As against this outlook, Senator Goldwater has consistently expressed his adherence to a system of reduced expenditures, balanced budgets, and free enterprise.

### HERBERT HOOVER

If any man was entitled to be called the greatest living American, it was Herbert Hoover. In *Newsweek* of Aug. 17, taking off from Eugene Lyons's brilliant biography, I discussed the incredible smear campaign that made him the "author" of the great Depression. Because recent praise of him has come so largely from conservatives, it is instructive to recall the early judgment of an outstanding "liberal." In 1919, in "The Economic Consequences of the Peace," John Maynard Keynes



wrote: "The ungrateful Governments of Europe owe much more to the statesmanship and insight of Mr. Hoover and his band of American workers than they have yet appreciated or will ever acknowledge. . . . This complex personality, with his habitual air of weary Titan . . . his eyes steadily fixed on the true and essential facts of the European situation, imported into the Councils of Paris, when he took part in them, precisely that atmosphere of reality, knowledge, magnanimity, and disinterestedness which, if they had been found in other quarters also, would have given us the Good Peace." ❁

## 'Back to Mercantilism'

November 9, 1964

The imposition by the new Labor government of a "temporary" 15 percent surcharge on imports and tax incentives for exports is a disruptive and reactionary step. In the long run it can have only harmful consequences for Britain and the world.

The first effect must be to increase the cost of living for Britons. They will pay some 15 percent more for all the goods they buy from abroad (except foodstuffs, industrial raw materials, and unprocessed tobacco, which are exempt from the surtax). The very purpose of this measure is to discourage and cut down imports. But this means that it will adversely affect all the manufactured exports to Britain of all other countries. To that extent it must hurt and disrupt the export trade and export industries of these countries.

It will of course hurt our own export industries. It will hurt the export industries of the Common Market countries—France, West Germany, Belgium, Holland, Luxembourg, and Italy. It will hurt the export industries even of Britain's partners in the European Free Trade Association (how ironic that name now sounds)—Austria, Denmark, Norway, Portugal, Sweden, and Switzerland.

### SELF-DEFEATING

Immediately after imposing the import surcharge, the Labor government blandly proposed to these partners that they all start speeding up their reciprocal tariff cuts. The British even generously added that they would speed up tariff cuts on the EFTA products even if other members failed to follow suit. But it is estimated that the import surcharges, in effect, double Britain's tariff walls. Why didn't the new government simply exempt its EFTA partners from the surcharge in the first place?

It is possible and even probable that the Common Market countries and others will retaliate against the British move by raising their own tariff wall or subsidizing their own exports. The whole policy, in that case, will become self-defeating, and postpone still further the hope for any return to sanity in international trade.

The British excuse for this move was that there is a heavy deficit in their balance of payments and that, as one dispatch put it, they were "bleeding to death" financially. But they had brought this on themselves chiefly by the policy of continuous monetary expansion combined with cheap money. The sure way for a country to get a deficit in its balance of payments is to combine excessive monetary inflation with a pegged rate for its currency. What makes the British case even more serious than ours is that the equipment or methods in many of its industries are antiquated and inefficient.

### PRECEDENT OF CANADA

The first and chief cure for the British balance-of-payments crisis would have been to halt its monetary expansion and its cheap-money policies. But, like ourselves, it is afraid to do this partly through political timidity and partly because of the now fashionable idea that cheap money and continuous monetary expansion are necessary to maintain full employment. The Labor government even gave "assurances" that Britain has "no intention" of raising its bank rate. This means that it considers interest rates purely a political decision.

As long, however, as monetary expansion and cheap-money policies are continued, the import super-tariff and export subsidies will have at best a short-run effect. On May 2, 1962 Canada dropped its dollar value to 92½ cents, compared with 95¼ cents the day before and \$1.05 in 1959. This meant that overnight its imports were more expensive and its exports cheaper. Yet within two months Canada had a hemorrhage in its balance of payments and lost a third of its reserves. Its continued monetary expansion had brought on a flight of capital.

The United States is in no position to criticize the British action. We wanted them to keep money cheap to help us keep our own inflation going. Their import surcharge is the equivalent of our own "interest equalization" tax. Both are reactionary protectionist steps based on mercantilist fallacies exploded two centuries ago. Both are accompanied by hypocritical lip service to international cooperation and freedom of trade and capital movements. Both, ironically, are done by self-styled "liberal" and "labor" governments. ❁

## The Problems Ahead

November 16, 1964

Three weeks ago, in a column called "Why He Is Losing" (*Newsweek*, Oct. 26), I listed eight major reasons why it seemed probable not only that President Johnson would win a victory of landslide proportions over Senator Goldwater but why even the Republican minority in Congress would be cut down. These reasons ranged from the prosperity of the country and the power and prestige of a Presidential incumbent to Goldwater's inept campaign, his ambiguities and belated qualifications, his failure to support his vague generalities with specific and documented statements, and his nearly complete failure to make the economic case at all.

On Election Day, the Republican label on most candidates might as well have read "poison." It seems altogether probable that the great majority of votes were cast more *against* Goldwater and everyone associated with him than *for* Mr. Johnson. Probably the major reasons for Goldwater's defeat had to do with his personal image rather than with his stated conservative philosophy—the fear, justified or unjustified, that he was "trigger happy," not only about the nuclear bomb, but about other matters—that he was rash and unpredictable. The saddest aspect of the whole matter is that the election will be interpreted as a defeat for economic conservatism, and yet that the case for economic conservatism was never really made.

### MONETARY EXPANSION

Mr. Johnson and the Democrats have won a great victory. But it is easier to win an election than to solve the grave problems with which the country is still confronted. It is outside the province of this column to discuss Vietnam, Cuba, Russia, Communist China, NATO, or the bomb; but the economic problems are no less troublesome.

It is true that through the \$11.5 billion tax cut, leading us to the 29th deficit in 35 years, and through policies calculated to hold down interest rates, the Administration has helped to keep going a remarkable period of prosperity. But this has not been done without risks, and these risks are growing.

To keep interest rates down, the Federal Reserve System has bought \$8 billion of marketable securities since 1960. This has overstimulated borrowing and expanded the money supply. Between the end of 1960 and September 1964, total commercial bank credit increased at an average annual rate of 8.2 percent. Since the beginning of the current economic expansion in February 1961, the nation's money supply (demand deposits plus currency) has risen at a 3.3 percent annual

rate. Since June it has risen at a 6.4 percent rate. Since February 1961, money plus time deposits have increased 8.2 percent per year. Since last June they have risen at an 8.4 percent rate.

### FALSE REMEDIES

The first effect of this abnormal expansion of money and credit has been to take up the slack in various sectors of the economy. But as this is done, the effect must be more and more to push up prices. Living costs have reached the highest monthly level on record. Industrial raw materials rose 15 percent in the twelve months ending in September.

The inflation has been most clearly reflected in the cumulatively mounting deficits in our balance of payments. This has been the direct outcome of our policy of holding down interest rates and increasing the money supply. Instead of halting these inflationary policies, we have imposed a shortsighted tax on purchases of foreign securities. This hurts borrowing countries, obstructs free international movement of capital, and in the long run only hurts our export trade and does nothing to solve the balance of payments.

Another false cure is to try to hold down the price of steel and other commodities by extralegal intimidation. This discriminatory treatment can only hurt the steel industry and therefore steel labor. If our so-called "wage guidelines" were taken seriously they would be dangerous economic nonsense. In practice they are mere pious government talk, though unions are encouraged to regard them as floors rather than ceilings.

This inflation is the great domestic problem that the new Johnson Administration now faces. ❁

## Market Is Color-Blind

November 23, 1964

With all the agitation in recent years for equal civil and economic rights for Negroes, it is strange that so little analysis has been directed to the economic delusions and measures that have encouraged discrimination and the economic reforms that might remove or mitigate it.

A book just published in London by the Institute of Economic Affairs and Andre Deutsch—*The Economics of the Colour Bar* (15 shillings)—goes a long way to make up this deficiency. It is written by an eminent South African economist, Prof. W.H. Hutt. While it is chiefly devoted to the racial situation in South Africa, the author tells us that it simply uses the experience of that country in an attempt "to expose the ultimate origins of colour injustices generally."

The central theme of the book is that if South Africa had continued the development of an economy of competitive economic freedom, it would have ameliorated or prevented the racial tensions there. But these have been aggravated by the government's restrictionist policies and by the efforts of higher-paid white workers to protect privileged positions.

### COST OF PREJUDICE

Hutt's main point is that a competitive free-market system is colorblind: "When we buy a product in the free market, we do not ask: What was the colour of the person who made it? Nor do we ask about the sex, race, nationality, religion, or political opinions of the producer. All we are interested in is whether it is good value for the money. Hence it is in the interest of businessmen (who must try to produce at least cost) . . . to seek out and employ the least privileged classes."

Employers are not necessarily free, or freer than others, from racial, sex, religious, or nationalistic prejudices. But their prejudices always cost them money. If a Negro can perform as good a job as a white worker for less pay, or turn in a better job for the same pay, a white employer who refuses to employ him simply because of his color merely injures himself. His prejudice reduces his potential profit, and may even imperil his economic survival.

In the eyes of an anticapitalist mentality, employers can never do anything right. They are now getting the chief brunt of the blame for discrimination against Negroes in hiring practices. Yet what they were always blamed for in the past was their *failure* to discriminate against women, Negroes, immigrants, and others. Read the leftist history books, and you will find American employers being denounced for favoring freedom of immigration so that they could always be sure of a "cheap" labor supply. Or of employing Mexican "wet-backs" in the Southwest, or Negroes anywhere instead of whites.

### PHILADELPHIA STRIKE

A main problem of employers in the past, however, has been to get many white-dominated unions to admit Negroes or accept them as fellow employees. A dramatic example was the Philadelphia strike twenty years ago. The country was at war. On Dec. 27, 1943, the Philadelphia Transportation Co. was ordered by the President's Fair Employment Practice Committee to stop discriminating against Negroes in upgrading employees and training new ones. The company replied that it had no objections provided its employees would not consider this a violation of the union contract. The union protested, and nothing was done.

On July 8, 1944, however, the company posted notices in its barns stating that it was accepting all qualified applicants for employment. Shortly afterward eight maintenance workers, all Negroes, began training as motor-men. On Aug. 1, a strike broke out, accompanied by rioting. It quickly spread to all 6,000 employees. The city's 1,982 streetcars, 369 subway and elevated cars, and 564 buses were brought to a halt. The strikers voted against returning to work, even under Army control, unless given guarantees against the employment of Negro operators. The strike lasted a week, and was brought to an end only when the Federal government issued an ultimatum that strikers that did not return to work would be drafted into the Army.

Federal law cannot continue explicitly to sanction the compulsory union shop and at the same time to tolerate the closed union. ⚙

## Labels vs. Policies

November 30, 1964

The Republican defeat is causing considerable soul-searching within the party. What went wrong? How can the party be put together again? So far the leading conciliator is Richard M. Nixon, who doesn't want either the "conservatives" or the "liberals" purged from the party. Each "deserves a party voice, but neither can dominate or dictate—the center must lead."

It all sounds very reassuring. But what does it mean in terms of specific policies? Just where is the "center"? Why is it superior to either the "right" or the "left"? Why is a "moderate" admirable and an "extremist" dreadful? By what criteria do you identify either? What, in brief, do the terms mean?

What Nixon seems to be looking for is the winning catchwords rather than the right policies. In politics, unfortunately, catchwords and slogans are tremendously important. A large part of the explanation of Goldwater's defeat was that he got pinned on him, and even embraced, the *wrong* catchwords. The Rockefeller wing smeared him as an "extremist," and with calm effrontery called themselves "moderates." Goldwater's cue was to insist that he was the moderate and they the extremists. But he made the fatal mistake of defiantly accepting both labels as pinned.

### 'EXTREMISM' UNDEFINED

By far the best analysis of this whole battle of the catchwords was made by Ayn Rand in her *Objectivist Newsletter* of September. The "moderates" were demanding a repudiation of "extremism," as she pointed out,



*without any definition of that term.* Extremely *what?* Moderately *what?* Is moderate honesty preferable to extreme honesty?

This confusion of labels did not begin in the last campaign; it was merely intensified. For more than a generation now we have been abusing and misapplying the terms “conservative” and “liberal.” In the best sense a conservative means one who wishes to conserve what is best in our heritage. In its origin as a political label in Britain in 1830, “conservative” was opposed to “subversive.” But historically the name has come to indicate opposition to all change, good or bad. Ironically, it is chiefly applied in the United States today to the unapologetic defenders of capitalism, of free private enterprise, free trade, and free markets. But capitalism is a progressive and even a revolutionary philosophy and set of institutions. In the last two centuries, it has changed the face of the earth and the lot of man. It has been doing so at an accelerative rate. The defenders of free enterprise, from Adam Smith on, have been the true liberals.

#### **‘LIBERALISM’ STOLEN**

But the noble term liberalism, from the same root as liberty, has been appropriated by the collectivists, the socialists, the New Dealers, the paternalists, the welfare-statists, the controllists. The idea has been propagated that true progress consists not in more freedom but in bigger and bigger government and more and more state coercion and control.

I cannot believe that the vote for President Johnson and the Democrats and against Goldwater and the Republicans was a conscious rejection of the philosophy of free enterprise. The vote against Goldwater was mainly the result of misgivings, however unjustified, about his own judgment and temperament. He never adequately stated the case for free enterprise. Above all, he never adequately analyzed the specific economic policies that the Johnson Administration was supporting.

And so we will have Mr. Johnson pushing economic policies that can only in the long run have the most harmful results—more tax reduction in the face of unparalleled spending, more deficits, more welfare programs, medicare, more controls, more “guidelines” for prices and wages, more power for unions, more monetary inflation, more threats to the integrity and stability of the dollar. It will be a tragedy if the Republicans—and far-sighted Democrats too—do not oppose all these programs with intelligent analysis.

The Republicans, in brief, should not ask what is the most fashionable stance to take or slogan to embrace,

but what policies are best for the country. In the long run this will also serve best their own interests. ❁

## **The Coinage Crisis**

December 7, 1964

The U.S. Government is faced with a coin shortage and a very awkward problem in relieving it. A few months ago the Treasury doubled its coin-volume goals for this year and 1965. Congress approved construction of a new mint, but it won't be ready before 1967. Since spring, both U.S. mints, in Philadelphia and Denver, have been working around the clock seven days a week. All twelve Federal Reserve Banks now ration coins to their member banks. In late August, Congress passed a bill indefinitely extending the 1964 date on all coins into 1965—and possibly thereafter—to discourage hoarding or speculation by collectors.

But the problem goes much deeper than the past failure of the government to do sufficient minting. It lies in the rise in the consumption and in the price of silver. The demand for coins has increased because of the constantly rising volume of business as well as of prices—and also because of the increase in vending machines and in coin collecting. But the industrial demand for silver has been rapidly increasing, not merely for its older uses in plate and jewelry, but for photography (for which no present substitute exists), for electronics, and for space technology.

In 1963 world consumption of silver in industry and coinage was estimated at 422 million ounces, whereas new mine production was only about 238 million ounces. This imbalance between production and consumption largely explains the rise in silver prices.

#### **BOOM IN SILVER**

Why hasn't the increased demand and price led to the production of more silver? The answer is that two-thirds of current output is merely a by-product in the mining for other nonferrous metals. Mining activity is mainly determined by the market for these metals rather than for silver. The difference between current production and the much greater current consumption is made up partly by purchases from government stocks.

The price of silver went up to \$1.29 an ounce in July 1963. It has not gone higher, in spite of increased demand since, because this is the official price at which the government redeems its silver certificates. As long as it stands ready to do this, \$1.29 will remain the ceiling price. But if the government stopped “selling” silver at this price, or if its monetary stock of 1,387,000,000



ounces of silver ran out, the price would be free to move to \$1.38 or more. At that price silver coinage in circulation (more than \$1 billion) would be more valuable as bullion than as money, and would be melted down or exported.

At the new annual minting rate of 275 million ounces, the government's silver stock will be used up in five years. Speculative action could bring a crisis much sooner. (Fuller presentations of the existing situation can be found in an article by Elizabeth Gillett in *The Commercial and Financial Chronicle* of Aug. 27 and in a pamphlet study by Dr. Elgin Grose-close published by the investment firm of Cyrus J. Lawrence & Sons.)

### POSSIBLE REMEDIES

Disregarding proposals that would only make the situation worse, three possible solutions have been offered to this problem: (1) an immediate cut in the silver content of all newly minted silver coins to one-half or less; (2) a complete abandonment of silver in subsidiary coins, substituting some cheaper metal; and (3) the Grose-close proposal to revalue all silver in circulation by double.

The snag in the first two proposals is that either would probably lead to immediate hoarding of existing silver coins, causing a serious coin shortage until perhaps the existing full supply had been replaced. The third proposal is designed to avert this, but might cause it to an even greater extent while it was being debated in Congress. It would mean a windfall profit to holders of such coin. More importantly, it would cause great confusion to count a dime as 20 cents, a quarter as half a dollar, and a half dollar as a dollar, particularly if substitute coins circulated side by side.

But the longer action is postponed the more serious the problem will become. A fundamental cause in the rise in the price of silver in the last 25 years, of course, has been the depreciation of the dollar through inflation. ❁

## The Sterling Crisis

December 14, 1964

Never before has any British Government made so many economic blunders in so few weeks in power. First, the new Prime Minister, Harold Wilson, announced the imposition of a "temporary" 15 percent surcharge on imports and tax incentives for exports. The effect was to injure and disrupt the exports to Britain of all other countries, even of its six economic partners in the European Free Trade Association, and to provoke

murmurs of retaliation everywhere. Worse, the action was accompanied by "assurances" that Britain had "no intention" of raising its bank rate—in other words, that it had no intention of taking the first indispensable action toward curing its balance-of-payments problem.

Of course this provoked distrust of sterling, and a rescue operation had to be undertaken. So on Nov. 7 ten of the world's leading financial powers agreed through the International Monetary Fund to extend \$1 billion in aid to Britain. But Wilson shook confidence further by announcing his determination to renationalize the steel industry. He hinted at new punitive taxes against corporations and investors, including a capital-gains tax. He increased pension and other social-welfare benefits.

### THE 'SPECULATORS'

Sterling weakened again. Wilson gave new reassurances. Central banks and others thought there would at last be an increase in the British bank rate at the regular weekly meeting on Thursday, Nov. 19. It didn't occur. The run on sterling started. Hurriedly, over the weekend, the British Government raised the discount rate from 5 percent to the crisis level of 7 percent. A Swiss banker made the premature declaration that "7 percent will drag money from the moon." He forgot that it won't do this if lenders are afraid they won't get their principal back. The run continued, and wasn't stopped until Nov. 25 when eleven nations announced that they had put together a record \$3 billion rescue package of currencies to defend the pound.

So the pound, once more, is rescued, and is presumably safe for at least the next three months. But what then? The notion so widely circulated in the press that the whole crisis was caused by a group of wicked speculators, "the gnomes in Zurich," is simply childish. It is hard to imagine any group of speculators foolish enough to imagine that they could permanently depress sterling by their own short sales. The "speculators" in sterling were the holders of sterling all over the world—central banks, commercial banks, exporters, importers, and investors everywhere. They were scared by the Wilson blunders. They wanted to get out. They wanted to protect themselves against being swindled as the holders of sterling were swindled by the devaluation of the pound from \$4.03 to \$2.80 in September 1949.

### THREE CHOICES

The total \$4 billion or so of credit at best gives the British Government a breathing spell. Otherwise it solves nothing. The future of the pound depends on the policies that the British Government follows.

It has three possible courses. First, it may try to save the pound by more of the same kind of controls as the

15 percent import surcharge and the export subsidy. It may resort to exchange controls, investment controls, import quotas and licenses, compulsory exports, price and wage controls at home, and all the rest. But the world, and particularly the British, have become disenchanted with these methods. They would mean a return to inconvertibility, and at least two prices for sterling.

Secondly, the British could devalue the pound or, through the IMF, try to get a world devaluation of currencies in terms of gold.

Finally, Wilson could stand by tight money, and stop the printing presses that have been turning out a glut of paper pounds. But this might lead to credit contraction and, particularly if the British unions continue with their usual demands, to a slump and unemployment. This violates all the policies that the Labor Party has been preaching for the last twenty years.

The problems of the dollar are different in urgency, but not in nature, from the problems of the pound. The fool's paradise of budget deficits, cheap money, and printing-press currency cannot go on forever. ⚙

## Cheap-Money Mania

December 21, 1964

The crisis in the British pound, brought about basically because the Bank of England had been glutting the market with too many pounds, should have been a grim warning to our own government on the ultimate consequences of its similar policies with the dollar. Instead, Washington decided to embark on still more credit inflation.

Addressing the Business Council, President Johnson on Dec. 2 warned the nation's 14,000 banks that in spite of the increase in the discount rate to 4 percent, he did not think "any general increase in the rates which banks charge their customers" was justified. Immediately one of the four banks that had announced a rise in their "prime" lending rate from 4½ to 4¾ percent canceled the increase.

The President's warning was tantamount to an extralegal form of selective price control. By itself, it might have been ineffective. But it was accompanied by a still more extraordinary action on the part of the Federal Reserve authorities. In the same week they bought nearly \$1.1 billion of Federal securities. In other words, they poured that amount of high-powered money into the commercial-banking system, and flooded the short-term loan market with funds.

## POURING IN FUNDS

Let us look at a few comparisons. From the end of 1957 to the end of 1963, the Fed's holdings of government securities rose from \$24.2 billion to \$33.6 billion. This meant that in those six years the Fed was buying government securities, and monetizing them, at a rate of \$1.6 billion a year. This monetary inflation has been the major cause of the deficit in the U.S. balance of payments that began in 1958. But here was an increase in monetized security holdings of \$1.1 billion in a single week.

This cannot be dismissed as a merely "seasonal" increase. It brought the Fed's total holdings of government securities to \$37.4 billion, an increase of \$3.4 billion over the corresponding week of the year before. The Fed's action directly contradicted the small increase in the discount rate.

The President's interest-rate warning must tend to shake confidence. Like his steel-price warning, it was a sort of extralegal price-fixing. It was unnecessary, because the competition among 14,000 banks assures a free market rate. The course the President suggested, moreover, is the opposite of what now needs to be taken. He asked the bankers to "consider the long-term interest of the nation." But it is precisely the long-term interest of the nation that now calls for tighter credit rather than easier credit, for a halt instead of an increase in new money-and-credit creation, in brief, for a halt in inflation. This is above all necessary to halt the deficit in our balance of payments, about which the President is so rightly concerned.

## CRISIS TO CRISIS

Behind the President's warning, behind the Fed's debt-monetization, behind the crisis in the British pound, and leading to it, is the fashionable fallacy that constant easy money and constant credit expansion are necessary to prosperity and "economic growth." But this international inflation game is leading the world from crisis to crisis. It led to the devaluation of the pound from \$4.03 to \$2.80, and the corresponding devaluation of nearly every other major currency, in 1949. It forced the U.S., with the help of a few European banks, to extend a billion-dollar line of credit to save the Italian lira last March. It forced leading nations first to extend \$1 billion aid to save the British pound early in November and then \$3 billion more credit a few weeks later to save it again.

How long can these melodramatic rescue operations, in increasing amounts, go on? And what makes them necessary? They are necessary because the world, having thrown away the discipline of the gold standard, has found nothing to take its place. Under the old gold standard, when a country found itself losing gold it

quickly had to raise its interest rates and halt its credit expansion to stop the outflow. Now it appeals to other central banks to bail it out by swapping paper currencies and maintaining a synchronized world inflation. That house of cards must some day tumble. ❁

## The Paper-Work Jungle

December 28, 1964

On Oct. 30, 1963, the Federal Power Commission sent out to 114 natural-gas producers a mammoth questionnaire weighing an average of 10 pounds. The questionnaire contained some 428 data sheets calling for data going back to 1955. One company estimated that completion of the forms would require 17,000 man-hours and cost it \$85,000 in salaries.

This incident is not exceptional. Almost everyone who files an income tax, particularly if his income does not all come from a single source, is obliged to become a part-time accountant, or to hire one.

Ten years ago (when the Federal government, as measured by expenditures, was only two-thirds as big as it is today) a task force of the Hoover commission studied both the volume of government paper work and the paper work that the government imposed upon private industry and the private citizen. The task force found that each year the Federal government handled 25 *billion* pieces of paper, not including pamphlets and books. The government employed more than 750,000 full-time workers to handle them and spent more than \$4 billion yearly. (That sum would have paid the entire cost of the Federal government as late as 1932.)

Each year the bureaucracy made out 3 million purchase orders to buy supplies. Each year government bureaus wrote a billion letters, at a cost to the taxpayer of \$1 each. Compared with 40 years before, each employee was writing about ten times as many letters. As the number of employees had increased sevenfold in that time, the total of government letters had increased 70 times.

### DUMPED ON THE FLOOR

As to the burden of paper work laid by the government on private citizens, the task force found it impossible to estimate the total. But here are a few examples: there were 4,700 requirements by the Federal government

on private industry to report statistical data. Before a utility company made an addition to an existing plant, no matter how small, it had to obtain a certificate from the Federal Power Commission to prove its original cost. The FPC's request for such data covered 82 pages, and the utility company's average report often ran to 1,000 pages with supporting schedules, took 7,500 man-hours, and cost more than \$25,000 to prepare.

It was estimated that the 4 million small business concerns of the country spent at least 5 percent, and in some instances as high as 29 percent, of their time on government paper work. Often there was no time limit on how long business had to keep these records. Yet one bureaucrat reported that copies of the payrolls that the government had demanded were so little used that he dumped them in barrels on the bare floor of empty storage rooms.

So much for the situation as officially reported ten years ago. In spite of the recommendations of the Hoover commission, is the situation any better today? On net balance it is far worse. A Congressional subcommittee headed by Rep. Arnold Olsen has so far published 752 pages of testimony on the subject. I can refer only haphazardly to some of it.

### ONE WORKER, 29 FORMS

Testifying on behalf of the National Association of Manufacturers, Dr. Lewis E. Lloyd estimated that many individual companies are filing reports to the government numbering in the hundreds of thousands each year. Their number and complexity constantly grow. "There can be little doubt that government-induced paper work has been an important factor in causing small-owner businesses to go out of business or sell out to larger firms." Another major reporting burden recently placed on industry is the requirement to report to the government and the payee information on dividend and interest payments.

As for the small-business man, one example is the testimony of Stuart Finley of Falls Church, Va., who has to fill out a total of 29 Federal tax-reporting forms because he has one salaried employee.

In sum, the Olsen subcommittee report will show that there are about a billion Federal reports a year from the public (including business, industry, social security, internal revenue, etc.). This is over five for every man, woman, and child in the United States. ❁

1965





## Abridging Free Speech

January 4, 1965

The National Labor Relations Board, in a 4-to-1 decision, has held that the General Electric Co. did not bargain in good faith with the International Union of Electrical Workers.

It would take a full recital of the record to show just how fantastic this decision is, but two aspects of it deserve special consideration.

The board majority argues that the company was not bargaining in good faith because it purportedly made an offer with a “take-it-or-leave-it” attitude.” What did the board expect the company to do? Did it expect it to keep on making further concessions indefinitely, after it had already conceded as much as it felt it could afford? Or did it (as the company asks) expect General Electric to hold back from its initial offer, for last minute settlement, some substantial item that the IUE had demanded, so as to allow the union to create the appearance of having forced this item from the company against its will? Does the board expect sham and ritualistic play-acting at the bargaining table, or protracted oriental haggling?

As the NLRB itself decided in the Philip Carey case in 1963: “That the respondent considered its offer as final is a matter of its own judgment. One need not listen to argument endlessly. There comes a point in any negotiations where the positions of the parties are set and beyond which they will not go.”

### DOUBLE STANDARD

But in the eyes of the NLRB majority, General Electric was guilty of other crimes. It sought “to create the impression that the employer rather than the union is the true protector of the employees’ interests.” Many economists would say that this is the simple truth. It is, after all, the employer who provides their jobs and their wages or salaries; they might get these without the union, but not without the employer. But, whether this is true or not, is the employer to be forbidden to say it?

The NLRB majority held the company guilty of “the purpose of disparaging and discrediting” the union officials in the eyes of the union members. Its decision said nothing whatever about the disparagement of the company by the union leader, James B. Carey, though the board’s own trial examiner referred to Carey’s “explosive temperament (several times to the point of threatening physical violence)” and to his “uninhibited” talk and “invective.”

But what is most amazing is the board’s ruling that it was an unfair labor practice even for General Electric to try to influence or communicate directly with its own

employees. Is an employer to be denied the right to keep its employees and the public informed regarding the facts or his point of view on issues under negotiation? Are the rights of union members to know what is going on to be limited solely to what the union officials want to tell them?

### REMEDIES

The NLRB’s decision is in effect a denial to employers of the right of free speech guaranteed by the Constitution and even by Section 8 (c) of the Taft-Hartley Act: “The expressing of any views, argument, or opinion, or the dissemination thereof, whether in written, printed, graphic, or visual form, shall not constitute or be evidence of an unfair labor practice under any of the provisions of this act, if such expression contains no threat of reprisal or force or promise of benefit.”

All anti-employer laws and rulings are, in the long run, anti-labor laws and rulings. Whatever penalties, uncertainties, and harassments cause investors to hesitate in starting new businesses or new plants must retard more employment or better wages.

What can be done? There is no point in arguing that the NLRB ought to make less one-sided and fantastic decisions. Recently it has been making more and more one-sided and fantastic decisions. A salutary step might be to abolish the NLRB and give the regular constitutional courts full jurisdiction, in law and equity, in all cases arising under the Taft-Hartley Act. A minimum reform would be to strike the “good faith” provision from the act, which enables the NLRB to find employers guilty of not making enough concessions. Has the Taft-Hartley Act become, in effect, a one-sided legal compulsion on employers to make concessions? ❁

## Paradise by Deficit

January 18, 1965

The history of liberty is the history of the limitation of governmental power, not the increase of it.” So wrote Woodrow Wilson. Yet in his terms as President he presided over an enormous increase in the power and size of government. And every President since Herbert Hoover has presided over a still further increase in the power and size of government.

Each President has insisted on giving his program a new label—the New Deal, the Fair Deal, the New Frontier, the Great Society—and yet each program has been essentially an expansion of the previous program—a further boost in spending, a bigger bureaucracy, an aggrandizement of governmental power, an

increased intervention in the daily life of the private citizen.

It would use up all the rest of this space even to list the new Federal programs or expansions of old programs—for education, housing, health, conservation, the “war on poverty”—that Mr. Johnson proposed in his State of the Union Message. Ten years ago, when the Federal government was spending only two-thirds as much as it is today, the Hoover commission found that it embraced 2,133 different functioning agencies, bureaus, departments, and divisions. How many does it embrace now? How many more will it embrace if the President’s new program is enacted?

### THE GREAT FICTION

The Federal government is spending 167 times as much in a single year as it was in the year before we entered World War I. Will every President, every year, be expected to think up more and more functions for the Federal government to take over from the private sector to the “public sector,” until there is no private sector or initiative left?

The great miracle about all the wonderful new things that the government is going to do for us under the Johnson program is that they are not going to cost anybody anything. Instead of asking for an increase in taxes to meet all his recommended increases in expenditure, the President promises “a substantial cut in excise taxes” so that “more money will be left in the hands of the consumer.” He even assures us that the increased spending and tax cuts will carry us “along the path toward a balanced budget.” Once we cut the annoying connection between expenditures and taxes, all other miracles become easy.

Mr. Johnson’s State of the Union speech is a perfect illustration of the French economist Bastiat’s definition more than a century ago: “The state is the great fiction by which everyone tries to live at the expense of everyone else.” Nobody will pay for the education of his own children, but everybody will pay for the education of everybody else’s children. Nobody will provide for his own old age, but everybody will provide for everybody else’s old age. No one will pay his own medical bills, but everyone will pay everyone else’s medical bills.

### DOLLAR ENDANGERED

What is overlooked is that the government cannot pay anything to anybody without ultimately taking the money from someone else. All production, and all real income, must come from private initiative and private enterprise. The government does not add to production; all it can do is to change the particular goods or services produced. What it encourages in one direction it must discourage in another. Every subsidy or handout to A,

B, or C must be paid for by an added tax on M, N, or O (and probably on A, B, and C as well). Increased government expenditures, instead of meeting more human needs, may meet fewer, because more taxes tend to deter production more than government expenditures tend to increase it.

The great miracle is supposed to be brought about by deficits. But deficits mean inflation, which is a disguised tax that reduces the purchasing power of everybody’s money. Our inflation has done that comparatively little in recent years because so much of our increased money supply has flowed abroad through a deficit in our balance of payments. But this cumulative deficit has been undermining the strength of the dollar. Once confidence in the dollar goes, it will be impossible to measure the extent of national and world calamity. Our first order of business is to see that this does not happen. ❁

## No Gold at All?

February 1, 1965

Since the end of 1957, our official gold stock has fallen from \$22.8 billion to \$15.4 billion. In the same seven years the country’s money supply (demand deposits and currency) has risen from \$136 billion to \$161 billion. If we also include time deposits, our money supply has increased from \$193 billion to \$285 billion. So against our active money there is now less than a 10 percent gold reserve, and against our money supply including time deposits there is only a 5 percent gold reserve.

All this is nowadays considered academic because our own citizens can no longer demand gold for their paper money. But vis-à-vis foreigners our position is increasingly embarrassing. Against our gold supply we now have short-term liabilities to foreigners of \$28 billion (against only \$15 billion at the end of 1957).

### 25 PERCENT RESERVE

We are obliged to keep by law a 25 percent gold reserve against the combined note and deposit liabilities of the Federal Reserve banks. This requires as of now a legal gold reserve of a little more than \$13 billion. This means, it is being said, that we can legally let only about \$2 billion gold move abroad in response to demands by foreigners.

So many people are asking that the 25 percent gold-reserve requirement be abolished entirely as “meaningless.” This, they tell us, will “free” *all* our gold reserves for foreigners who want to convert their dollars into gold; and once foreigners know that this huge supply is available, they will not want to convert; our gold

hemorrhage will be stopped, and confidence in the dollar will be restored. The President has let it be known that he will either ask for such a change in the law, or at least removal of the gold-reserve requirement against deposits if not against notes, so “releasing” nearly \$5 billion more of gold.

There are serious factual misconceptions as well as economic fallacies behind these proposals. Though it will of course be necessary, if gold convertibility is to be maintained, to let gold be drawn out even if our gold reserve falls below 25 percent, this is already provided for in the law as it stands. But the law also provides for progressive tax penalties and rises in interest rates as the gold reserve is allowed to fall. Are the advocates of reducing or wiping out the 25 percent gold reserve asking for the abolition of these penalties—and of any other restriction on the expansion of credit? How can the removal of such penalties or restrictions on monetary expansion increase foreign confidence in the dollar?

#### NEED FOR DISCIPLINE

It is, in fact, a little difficult to see the basis for the belief that making our whole \$15.4 billion of gold legally free to leave the country will completely reassure foreigners. Our total short-term liabilities to foreigners now reach \$28 billion (of which \$24.6 billion are to banks and official institutions). Against these we have only \$6.9 billion short-term claims on foreigners. Whatever way we figure it, our gold falls short.

Abolishing the last vestige of a legal gold reserve against our money would not solve anything. It would further shake confidence of Americans in their own currency, and would give at best a short-run reassurance to foreigners.

Only one thing will cure the deficit in the balance of payments and assure confidence in the dollar. That is monetary discipline. And the government does not intend to have any.

If the government really means to maintain dollar convertibility at \$35 an ounce in gold, it must immediately stop further expansion of the money-and-credit supply. In today's ideological atmosphere such a proposition will be regarded with blank incredulity. For it is the fixed (but fallacious) belief of our government authorities that it is necessary to have cheap money and a continuous expansion of the money-and-credit supply to maintain “economic growth” and “full employment.” So the authorities are systematically blind to the effect of this cheap money and inflationary expansion in causing the deficit in the balance of payments and the declining confidence in the dollar. Instead of stopping the policies that are causing the disease, they

plan to extend the penalties on Americans who lend or invest abroad. ☸

## The Cult of Deficits

February 15, 1965

In 1932 the Hoover Administration was spending at the rate of \$4.6 billion a year. “Stop the spending!” candidate Roosevelt demanded. The majority of voters agreed, and elected him President. Today the Federal government is spending \$121.4 billion a year, and planning to spend \$127.4 billion in 1966, a new record, 28 times as much as in 1932. The increase alone in next year's spending will be greater than the whole amount spent in 1932. But the Johnson Administration insists that this is “not extravagant,” and Congress probably will agree. Such is fiscal progress.

“For three long years,” warned President Roosevelt on March 10, 1933, “the Federal government has been on the road to bankruptcy. . . . [By the end of the fiscal year 1934] we shall have piled up an accumulated deficit of \$5 billion. . . . Too often in recent history liberal governments have been wrecked on the rocks of loose fiscal policy.” The deficit that President Johnson is deliberately planning for fiscal 1966 will be the 30th in 36 years. It will bring the accumulated deficit since the end of 1930 not to \$5 billion, but to \$306 billion. Yet the concern most frequently voiced today is not over whether we may suffer the consequences of loose fiscal policy, but whether our deficits and spending are big enough to assure “growth” and “full employment.”

#### \$6 BILLION INCREASE

Mr. Johnson was able to squeeze at least his “administrative budget” spending below \$100 billion to the Macy's bargain figure of \$99.7 billion. Practically all the newspapers headlined that figure alone. The true spending of more than \$127 billion (whether as measured by the “total cash payments” budget or the “national income account” budget) barely got a mention in most of the news stories.

There is not space here to analyze in detail the various bookkeeping gimmicks by which even the “administrative” spending figure was kept below \$100 billion. (Those interested may consult articles in *The Wall Street Journal* of Jan. 26 and 27.) But one major point must be made. The new budget increases real spending over the present fiscal year, not by a mere \$2.2 billion, but by at least \$6 billion (as shown both by the full-cash and the accrual-basis budgets).



The theory of the new fiscal policy is that we must plan big budget deficits to prevent even bigger budget deficits. Nevertheless, on the argument that the “1966 administrative budget deficit of \$5.3 billion is \$1 billion lower than the 1965 deficit,” Mr. Johnson concludes that we are making “continued progress toward a balanced budget.” The argument is unconvincing. True, his *estimated* 1966 deficit is \$1 billion lower than his revised estimate of the 1965 deficit. But it is \$400 million more than his original estimate last year for the 1965 deficit. And if he has underestimated the 1966 deficit by the same amount, it will be \$6.7 billion—or *more* than the \$6.3 billion now estimated for 1965. Mr. Johnson’s assurance may prove to be as much a will-o’-the-wisp as Roosevelt’s of Nov. 29, 1935: “We can look forward with assurance to a decreasing deficit.”

### EMPLOYMENT RECORD

But now nearly everybody is placidly accepting deficits as normal practice, in bad times and good. They are necessary, it is said, to assure “full employment.” But in the past they have notoriously failed to do so. In each of the years from 1931 to 1940 inclusive, the Federal government ran a deficit average 3.6 percent of the gross national product. During those ten years there was average unemployment of 18.81 percent of the labor force. The same percentage of GNP and of the labor force today would mean that even deficits averaging \$22 billion a year could be accompanied by more than 14 million annually unemployed.

But isn’t the deficit policy a smashing success today, as its champions contend? President Johnson in his Economic Report boasts that “unemployment dropped from 5.7 percent in 1963 to 5.2 percent in 1964 and was down to 5 percent at year’s end.” He neglects to compare the record. In the four Kennedy-Johnson years (1961–64) unemployment averaged 5.5 percent; in the eight benighted Eisenhower years (1953–60) it averaged only 4.9 percent. ☸

## Surprising Scapegoat

March 1, 1965

The deficit in our balance of payments, and our continued loss of gold, are the direct result of our government’s own fiscal and monetary policies, and of nothing else. As long as the Federal government continues these inflationary policies, the dollar crisis will continue. But if the government returns to monetary discipline, and stops trying to push down interest rates or to “pump more purchasing power into the economy,” none of the

tax penalties, quotas, and controls that the President proposed in his balance-of-payments message of Feb. 10 will be needed.

Let us recall some of the policies that have led to the present dollar crisis. The government has been inflating the money supply for 30 years. Since the end of 1939 the supply of money has been more than quadrupled. For 1966 the President is deliberately planning to run the 30th deficit in 36 years.

Since the end of 1957 the deficit in our balance of payments has reached a total of \$25 billion, an annual rate of \$3.5 billion a year. During this period the government authorities have professed to be greatly concerned about that deficit. Yet during these same seven years they have increased the active money supply (demand deposits plus currency outside banks) by 17 percent, and the total money supply (including time deposits) by 48 percent.

During this period, also, the government has handed out some \$28 billion, or \$4 billion a year, in foreign aid. It is instructive to notice that this aid alone exceeds the cumulative balance-of-payments deficit of \$25 billion and its annual average of \$3.5 billion in the same period.

### INVESTMENT VILLAIN

But the government ignores all this and looks outside of itself to “the private sector” to find the villain that is causing the balance-of-payments deficit. And the scapegoat it picks is private foreign investment. This is not only arbitrary but surprising, because private foreign investment is the one outlay of money that is made with the very purpose of eventually bringing in more money than is laid out.

In the six years 1958 to 1963, for example, the aggregate net outflow of \$20.9 billion for new foreign investment was offset by \$19.4 billion of income from previous investment. Even Secretary Dillon has conceded that “in the long run the outflow of American capital to foreign countries is more than balanced by the inflow of income earned by that capital.” So the government’s attempt to discourage America’s foreign investment is at best shortsighted.

### END CHEAP MONEY

Instead of trying to make up nearly all of our \$3 billion deficit by penalizing our \$6.5 billion investment abroad, why didn’t the government pitch on some other major item in the total of nearly \$35 billion that we annually spend or give abroad? Since we are abandoning all liberal trade principles anyway, why not put prohibitive duties on luxuries, on perfumes, and liquor and foreign sports cars, and crack down on foreign pleasure travel?

Or if foreign investment really is the culprit, why not simply let interest rates go up here to levels where they would keep investment at home and even attract foreign investment? The cure is not more government interference with markets, but less.

Unless the President, the Congress, and the Federal Reserve curb deficit spending, slash foreign aid, stop pushing down interest rates, short-term or long-term, and stop printing more paper money, the extended tax and other penalty measures that the President has asked for against foreign investment will be simply futile. In the long run they will neither halt the balance-of-payments deficit nor stanch the outflow of gold. On the contrary, the misgivings that the stricter controls themselves arouse may increase both.

But if the government authorities adopt a self-imposed monetary discipline, if they stop the deficits, cut the foreign giveaway, stop flooding the market with more paper dollars, and allow interest rates to rise to free-market levels, the deficit in the balance of payments will stop *overnight*, and the elaborate tax penalties, quotas, surveillance, and “voluntary” controls of foreign investment will be entirely unnecessary. ⚙

## Manipulating Interest

March 15, 1965

Since the end of 1957, the government has become increasingly involved in economic policies that must have increasingly harmful results.

On the one hand it has been undermining the value of the dollar by progressively expanding the money supply to hold down interest rates. This has made it less attractive for either Americans or foreigners to lend or invest in the United States, and comparatively more attractive for them to lend or invest abroad.

But then the government, ignoring its own clear responsibility for this result, is determined to find the culprits among American private citizens. It has chosen for its chief whipping boys those American individuals, banks, or corporations attracted by the higher interest rates abroad.

In brief, in order to maintain its own cheap-money policy at home, the government has launched a series of what must be progressively tighter controls on investment, lending, and the foreign exchanges. As long as the government maintains its cheap-money policies, these penalty taxes and surveillance of loans and investments will be futile in their intended purpose of curing the balance-of-payments deficit. These “remedies” will prove, at best, short-lived. In the long run they can only

restrict our export trade, and set back both American and world development.

### HIGH-POWERED MONEY

Let us examine this process in detail. Since the end of 1957 the country’s active money supply (currency plus demand bank deposits) has been increased by 17 percent. Total money supply (including time deposits) has been increased by 48 percent. But if we direct our attention to the way in which the Federal Reserve authorities, egged on by the politicians, have been increasing the high-powered reserve money supply on which the inverted pyramid of our total money and credit supply is built, we get an even more striking set of comparisons.

The Federal Reserve banks, which are bankers’ banks, can *create* reserves for the member banks (the banks with which the public deals) against which the latter can in turn, by making loans and investments, create about six times as much deposit “money.” The Fed creates these reserves mainly by buying government securities from the member banks or the open market, and then “monetizing” them.

At the end of 1957 the amount of Federal Reserve credit outstanding was \$26.2 billion (\$1.1 billion less than at the end of 1952). In 1958 this outstanding credit was increased by \$2.2 billion, and in 1959 by another \$1 billion. In 1960 it was reduced by \$375 million. Then the Fed, under the new Democratic regime, began to inflate in earnest. In 1961 it increased Federal Reserve Bank credit by \$2.2 billion; in 1962 by \$2 billion more; in 1963 by \$3.4 billion more; and in 1964 by \$3.3 billion more. At the end of 1964 the total stood at \$39.9 billion, an increase in seven years of 52 percent. (Federal Reserve credit went up \$13.7 billion though our gold stocks went *down* \$7.4 billion.)

### RATES LOWEST HERE

The intention and effect of this increase of credit was to hold down U.S. interest rates. In its February letter the First National City Bank of New York presents a table comparing short-term lending rates in some 60 countries. (The interest rates compared are “the lowest at which business firms of the highest standing can obtain credit on an unsecured, single-name basis.”) The comparisons show that U.S. rates at 4½ percent are lower than in any leading country. The Canadian rate is 5¾ percent. The rates in France, Germany, Belgium, and Japan are above 6 percent. The range in Sweden, Italy, and Britain is around 7 and 8 percent. International comparisons of long-term rates would show a similar difference.

The situation, in brief, is this. The government, by its monetary policies, has brought about artificially low interest rates here. The result has been to divert lending

and investment into foreign countries. The government then picks on this foreign investment as the marginal culprit causing the deficit in our balance of payments. But instead of abandoning its own cheap-money policies, it starts lecturing, penalizing, and policing private investors. ❁

## Antitrust Chaos

March 29, 1965

Nothing more clearly reveals the contradictions and absurdities in our antitrust laws and their current interpretation than the decision of Federal District Judge Lloyd F. MacMahon that the 1961 merger creating the Manufacturers Hanover Trust Co. of New York violated the Sherman and Clayton Antitrust acts.

The court held that the merger violated the Sherman Act of 1890 because it was a "combination in unreasonable restraint of trade." Just how unreasonable? At the end of 1960, before the merger, the combined assets of the Manufacturers and the Hanover were 14.3 percent of the assets of all New York City banks. On June 30, 1964, the Manufacturers Hanover assets were only 12.3 percent of the total. The largest New York City bank, the Chase Manhattan, represented 21.7 percent of the total; the second largest, the First National City, represented 19.8 percent. Not counting nearly 1,000 branches, there are now 70 commercial banks in the metropolitan area. Would it noticeably affect the competitive situation if there were 71?

One of the gravest aspects of Judge MacMahon's decision is the uncertainty it creates for all large firms. The bankers who arranged the merger assumed they were doing a perfectly legal thing. They had got the explicit approval of both the New York State Banking Department and of the Federal Reserve Board. But a third branch of government, the Justice Department, filed suit after the merger was effected. Now, three and a half years later, the bank is asked to unscramble itself back into its former two shells.

### UNCERTAINTIES

Obviously the court's decision will unsettle not only the bank concerned but business generally. Laws should be reasonably certain in their application. If in the future a small bank or other business cannot adequately compete and wants to sell out, what existing larger firm (uncertain about future decisions) will have the courage to buy it? Such a prospect can discourage new ventures.

But there is no use arguing even that the merger of the Manufacturers and Hanover actually had beneficial

results, because Judge MacMahon says this doesn't matter. He agreed with the bank's lawyers that "the general public and small businesses have benefited" from bank mergers in the city. Nevertheless, he said, "practices harmless in themselves, or even those conferring benefits upon the community, cannot be tolerated when they tend to create a monopoly; those which restrict competition are unlawful no matter how beneficent they may be." It doesn't even matter if mergers promote efficiency and reduce costs, "for it is the theory of the antitrust laws that the long-run advantage to the community depends upon the removal of restraints upon competition."

### DOUBLE STANDARD

This brings us squarely to the economic question: do the courts, the Justice Department, or our lawmakers know what practices really restrict competition? Or which are in the long run harmful or beneficial? Obviously the merger of the Manufacturers and Hanover ended any competition *with each other*. But its purpose was to enable them to offer stiffer competition than before to their bigger rivals, the Chase and First National City. There is no evidence that this merger has caused poorer service to depositors or borrowers. The number of bank offices in New York City has increased since the merger from 645 to 698.

The truth is that the courts, the Justice Department, and Congress have shown no consistency whatever in opposition to "monopoly" *per se*. A bank that does one-eighth of the banking business of New York City is ordered to bust itself up. But a labor union can be industrywide and nationwide, and employers are legally compelled to bargain exclusively with it. The country's farmers are not only permitted but compelled to restrict plantings, so that consumers can be forced to pay higher food prices. The international coffee agreement, to which this country is a signatory, enforces quotas on export and hence on production, to keep prices up under the euphemism of "stabilizing" them. Why doesn't the Justice Department sue every senator who voted for that agreement? ❁

## Do We Need More Money?

April 12, 1965

With either mild or violent inflation taking place year by year in nearly every country, with a currency crisis breaking out somewhere every week, it is obvious that the world monetary system set up at Bretton Woods in 1944 is breaking down. Monetary economists realize



that it is breaking down. Almost daily someone puts forward a new plan for world monetary reform.

But the irony is that, though the disease is chronic inflation, nine tenths of the proposed “reforms” are based on the fear that this inflation may suddenly come to a halt, and plunge the world into a deflationary crisis. Therefore all these plans provide for a constant increase in “liquidity”—i.e., a further increase in the volume of credit and of paper money.

It is important to distinguish two schools of currency expansionists. The first are the extreme expansionists who believe that it is necessary to maintain a constant “full employment” boom by constant injections of “new purchasing power” into the economy. But employment does not depend upon the amount of money in existence. What it depends on is a proper coordination of prices with costs and wage rates. If this coordination exists, full employment and production will follow. If this coordination does not exist, if wage rates in key lines race ahead faster than prices and marginal labor productivity, there will be unemployment no matter how much new money is printed.

#### **‘KEEPING PACE’**

Yet there is a more subtle and more widespread form of inflationism. It consists in the belief that a constant increase in the money supply is necessary to “keep pace” with the increase in domestic production or the volume of world trade. Hence the chronic fears of a future “shortage of liquidity.” Hence the belief that “there isn’t enough gold in the world to carry on international trade.” Practically all the “world monetary reform” plans are therefore plans for more and more credit expansion and paper money.

Now there is one germ of truth in this belief. If the money supply remains constant, while production and trade expand, there will be a fall in prices. The error in the theory consists in assuming that such a fall in prices will imperil or wipe out profit margins and therefore create stagnation and unemployment. But this assumption overlooks that real costs, and therefore money costs also, will be falling along with final prices. Real profit margins will be retained. The living standards of the workers will be constantly bettered, not primarily through higher money wages, but through a higher purchasing power of their money wages. It is a serious fallacy to assume that a constant money supply would have the same kind of results as a suddenly contracted money supply, combined with inflexible prices and wages.

#### **INVERTED PYRAMIDS**

Expansion of the paper-money supply cannot go on forever. Our authorities now think that even a 25 percent

gold reserve is an excessive requirement. Yet this 25 percent reserve was only required against Federal Reserve notes and deposits. On top of these notes and deposits (themselves liabilities) we have built another inverted pyramid of commercial bank deposits. Twenty paper dollars are now outstanding against every gold dollar. Foreign central banks count such paper dollars as “reserves,” and have built still another inverted pyramid of money and credit on top of them. Of course under this setup the world’s monetary system is drifting toward a crisis. And this cannot be averted by printing still more paper money.

For an increase of the money supply, in order to increase “liquidity,” is in the end always self-defeating. If a country doubles the amount of its paper money, for example, it merely cuts in half the purchasing power of its monetary unit compared with what it would otherwise have been. It merely does business on a higher price level. But excessive printing of new money discourages saving, unbalances production, and creates instability and uncertainty.

As long as the superstition prevails that the amount of money needs to be constantly increased, the world will never get back to a sound and stable monetary system. Inflation must someday have a stop. ☸

## **Monster Government**

April 26, 1965

If any two government programs have proved themselves to be enormously expensive failures, they are the price-support program in agriculture and the foreign-aid program. Both were adopted ostensibly as “emergency” schemes. Both were originally supposed to serve their purpose in four years at most. Yet both are still in existence, and look as if they will be with us forever. No one any longer talks of a termination date.

The crop-subsidy program began some 30 years ago. It now costs \$4.6 billion a year. This is what the whole Federal government and all its programs cost to run in 1933. The purpose of the program is to reward farmers for producing less. Its effect has been to raise the cost of food to our own poor, to pile up huge unsold farm surpluses in government warehouses, and to stimulate food giveaways or cut-rate “sales” to foreign (including Communist) countries.

President Johnson has nothing to propose but a continuation of the program with slight modifications. The government will spend a little less, but in compensation Americans will pay more for wheat and rice.



### FARM BUREAUCRACY

Why does the farm program, in spite of its absurdities, go on? Partly, no doubt, because of pressure groups among farmers. But farmers are deeply divided about the wisdom of the program. Perhaps a more direct cause can be found in the 110,000 employees in the Department of Agriculture, most of whose jobs depend on the continuance of the program, and in whose interest it is to find arguments for that continuance.

Let us turn to foreign aid. From the end of the fiscal year 1945 this has come to the staggering total of \$110 billion. Congressman Passman tells us that during the current fiscal year our government will be disbursing some type of foreign aid in 99 foreign nations and nine territories; that there are now 22 Federal agencies dispensing some type of foreign aid, and that the total for the fiscal year 1966 will probably exceed \$7 billion.

Has this enormous expenditure accomplished its purposes? The evidence shows that it has promoted dependence and government "planning" and socialism abroad, discouraged sound international private investment, and on net balance retarded world economic development.

### AID BUREAUCRACY

Has it halted Communism? Has it even won friends and allies? The truth seems to be precisely the opposite. A shrewd Latin American commentator, Rodolpho Katz, in his weekly economic survey published in Buenos Aires, wrote recently: "There is no more pitiful role on the world stage than that of the savior. Help and aid are everywhere received grudgingly and resentfully. The United States is increasingly experiencing the truth of this, but without apprehending it. Having intervened in many countries in the supposed interest of its nationals, having extended generous aid, political and financial, the United States today is the most vilified nation of the globe, *simply because it has proffered aid.*" And he illustrates this by recent developments in Indonesia, Latin America, and Europe.

Why does foreign aid continue and even expand? Again, a major part of the answer is the bureaucracy that has been built up under it. As Congressman Passman points out: "There are 71,416 individuals, including participants, on its payrolls. . . . No program in the history of mankind has had as many paid lobbyists as the foreign-aid program. . . . [It] is not in reality a Presidential program. . . . It is a bureaucratic program. The President has too much to do to be able to familiarize himself with the many ramifications, misrepresentations, and claims of accomplishment by the paid bureaucrats, government lobbyists, spenders, and recipients."

May this not also be part of the explanation for the growth of the programs of the Department of Health, Education, and Welfare, with its 85,000 employees? Everywhere the full-time experts on these programs are also the people with the greatest interest in expanding the programs. Congress is forced to depend on their figures and arguments, and the programs become self-perpetuating and self-accelerating. ❁

## The Rueff Proposal

May 10, 1965

When President de Gaulle insisted on drawing more gold out of the United States in exchange for dollars, his action was interpreted here chiefly as more evidence of his anti-Americanism. And when he called for a return to the gold standard, people here and in England said he was asking for a world that was lost forever.

But then they became belatedly aware that the eminent economist Jacques Rueff, the author of the French monetary reform of 1958 (and the newest member of the French Academy), had been advocating these ideas for a long time. In fact his book, *The Age of Inflation*, published in paperback by Henry Regnery last year, reveals that he has been publicly asking for the abolition of the "gold-exchange standard," and a return to a world gold standard, at least since 1932.

He has recently been advocating this reform with increased urgency. Among the proposals for world monetary reform that have attracted recent attention, his stands out for one great merit: instead of proposing new gadgets to continue world inflation, it proposes to put an end to inflation.

### 'GOLD EXCHANGE'

The "gold-exchange standard" was formally adopted at an international monetary conference at Genoa in 1922. This meant that central banks were allowed to count as part of their reserves not merely gold, as previously, but foreign currencies that could be exchanged for gold, that is, sterling and dollars. The purpose was to "economize the use of gold" and to allow credit and currency expansion.

Rueff holds that the gold-exchange standard did harm from the very beginning. It "unquestionably triggered the disaster of 1929-1933." And today it is "chiefly to blame for the balance-of-payments deficit of the United States."

The evil of the system, as Rueff sees it, is this. Under the old gold standard, when a country lost gold it had to contract its credit and currency correspondingly. But under the gold-exchange standard, when the United

States has a deficit in its balance of payments, instead of paying gold to a creditor country, it pays dollars. These end up in the creditor country's central bank. "But the dollars are of no use in Bonn, or in Tokyo or in Paris. The very same day, they are re-lent to the New York money market, so that they return to the place of origin. Thus the debtor country does not lose what the creditor country has gained. So the key currency country never feels the effect of a deficit in its balance of payments." The result is that both debtor and creditor expand credit on the same base.

### **\$70 AN OUNCE?**

There is no doubt that this gold-exchange system—which might better be called the dollar-exchange system—is a major and almost inevitable cause of world inflation. As a minimum reform the central banks should no longer permit their dollar holdings to increase; and they should work out some provision for their gradual repatriation over a period of years.

But Rueff wants to make the reform at one stroke. He therefore suggests that the "world" price of gold be doubled from its present \$35 an ounce to \$70. This would automatically double the present \$14 billion remaining U.S. gold reserves to \$28 billion. The world's central banks could then convert their \$13 billion of dollar holdings into American gold, leaving the U.S. still with \$15 billion of higher-priced gold. Rueff argues that the U.S. and other countries would then have substantially the same reserves as before, therefore this reform would be neither inflationary nor deflationary. And the world would be back once more on a real gold basis.

But would it happen that way? Would not doubling the price of gold—i.e., cutting in half the legal gold content of every currency unit—not lead to an immediate rise in world prices? Would not most countries, finding their gold reserves suddenly almost doubled, set off on a new inflationary spree? What about the shock to the dollar and to our moral prestige if we broke our often repeated pledge to keep the dollar "immutably" at \$35 an ounce?

But whatever the remedy, Jacques Rueff has correctly identified one major monetary disease—the gold-exchange standard. ☸

## **Steel as Scapegoat**

May 24, 1965

Instead of keeping hands off the wage negotiations in the steel industry, the Administration has in effect said what it thinks the settlement ought to be. On May 4 President Johnson and the Council of Economic

Advisers implied that in their opinion the steel industry could give its workers a 3 percent increase in wages this year and still not need to raise its prices. Their action can only encourage the steel union to raise its demands. The Administration has set a mischievous precedent.

Both the statistical comparisons and the economic reasoning in the council's report on the steel industry are highly questionable. The steel industry has been arguing that since 1957 its labor costs have increased more than 4 percent a year while productivity has increased only 2 percent a year. The council, by not counting periods when strikes occurred (a method it has not applied to other industries), has figured that the steel industry's productivity has really risen 3 percent a year.

A number of questions arise concerning the government's "guidepost" calculations. There can be no doubt that hourly labor costs have risen faster in the steel industry than prices. Since 1959 steel prices have risen on the average about half of 1 percent. (Consumer prices have gone up more than 7 percent.) Hourly steel wages have risen 11 percent. Total hourly employment costs have risen 15.6 percent. The government holds, however, that "labor productivity" has gone up by 3 percent a year and therefore hourly wages should go up 3 percent a year.

### **LABOR PLUS CAPITAL**

Even if we accept the 3 percent figure, there are several things wrong with this reasoning. What the government is talking about is not in fact "*labor*" productivity; it is *labor-capital* productivity. This has been going up each year not because workers constantly work harder, but because more and better plant and equipment are constantly being supplied. If the whole gain in productivity that results is given to labor, then the incentive to further investment will be destroyed, and economic growth will slow to a halt. In a free market, wages depend on marginal labor productivity. This is a very different thing from average labor-capital productivity.

This is only one of the confusions of thought on which the CEA's "guideposts" are based. Another is the council's use of averages. Hourly wages in all manufacturing industries average \$2.60. But in the steel industry hourly wages average \$3.41 (and with fringe benefits, \$4.39). Should wages in every industry go up just 3 percent a year, no more no less, regardless of existing differences, or of changing demand, prices, and profits in each industry?

### **PROFITS MODERATE**

The council deplores the rise in steel prices, especially during the 1950s, but ignores the rise in wage costs that made price increases necessary. If steel price rises were

disproportionate, they would be reflected in high profit margins. But the compilations of the First National City Bank of New York show that in 1964 the steel industry's profit margin per dollar of sales was 6 cents, compared with an average of 6.1 cents in all manufacturing. In 1964, the steel industry earned only 9.2 percent on net worth compared with an average of 12.7 percent in all industry.

The total market value in 1964 of the nation's steel output was only 2.6 percent of the gross national product. The whole attempt to pick on steel prices as the scapegoat for inflation is not only absurd in itself but draws attention away from the real cause of inflation, which is the constant increase in the money and credit supply brought about by the government's own policies.

If the steel industry could really grant a 3 percent rise in wages without increasing prices, it would be equally true that if it did not raise wages it could lower its prices. And lower prices are needed to enable it to compete more effectively with foreign steel.

The assumption of government officials that they know just how much every wage and price should or should not go up can only lead to constant meddling and finally to totalitarian wage and price controls that could halt the growth of the economy. ☸

## The Right to Choose

June 7, 1965

The Taft-Hartley Act was in origin an amendment of the Wagner Act. It modified a few of that law's worst provisions, but it kept some of the most harmful. It gives labor unions a privileged status enjoyed by no other private group. It forces employers to bargain exclusively with them, even when their demands are beyond all reason. It is hypocritical. It makes it "an unfair labor practice for an employer . . . by discrimination in regard to hire or tenure of employment or any term or condition of employment to *encourage or discourage* membership in any labor organization." And then, notwithstanding, it explicitly sanctions imposition of the compulsory union shop.

But it does, in Section 14(B), make one indirect concession to the individual worker's right to freedom of choice. That section provides: "Nothing in this Act shall be construed as authorizing the execution or application of agreements requiring membership in a labor organization as a condition of employment in any State or Territory in which such execution or application is prohibited by State or Territorial Law."

Nineteen states have taken advantage of this to enact laws against making it compulsory for a man to join a union in order to hold his job.

### COMPULSORY UNIONISM

Union leaders have fought an unceasing war against Section 14(B). So President Johnson, though as a congressman he voted for Taft-Hartley, and as a senator voted against repealing 14(B), and in 1960 supported Texas's right-to-work law, is now paying his 1964 election debt to the union leaders. He is asking for the repeal of 14(B).

He gives no argument for his request, except the vague "hope of reducing conflicts in our national labor policy," and he does not point out frankly that the effect of this repeal may be to force workers everywhere to join a union in order to hold a job.

The effect of compulsory union membership is to relieve unions of any need to make membership attractive to workers. As Prof. Sylvester Petro remarked in his book *Power Unlimited* (1959), which described in detail the abuses of union power revealed before the McClellan subcommittee of the Senate: "The McClellan record reveals . . . that compulsory unionism is the principal cause of corruption and maladministration of unions; it draws into unions the kind of men who abuse union members, and takes from the members any real power to rid themselves of the looters."

### FREE DECISION

The argument for keeping Section 14(B) is elementary. As former Rep. Fred A. Hartley, one of the sponsors of the Taft-Hartley Act, put it: right-to-work laws "guarantee a worker's right to join a union"; but also "his right to stay out of a union if he wants to—and I say what's wrong with that?" As the Committee for Economic Development also recently summarized the case: "The controlling principle should be the right of an individual to decide freely to belong or not to belong to a union."

The proposed repeal of Section 14(B) is a naked grab for more power by the union bosses. There is only one argument for it that deserves intellectual respect. This is the argument for "freedom of contract." That argument holds that the law ought not to prohibit a "voluntary" agreement between a union and an employer requiring compulsory union membership; that union membership as a basis of continued employment should be neither required by law nor forbidden by law.

But in the mouths of union leaders this argument is insincere and hypocritical. They insist on the retention in the Taft-Hartley Act of the prohibition of the so-called "yellow-dog" contract—a contract in which



a worker agrees as a condition of employment that he will *not* join a union. Union leaders who insist on legalizing compulsory union membership should be willing to legalize compulsory *non*-union membership. But as long as they are not willing to do that, they have no right to use the freedom-of-contract argument. Meanwhile, also, opponents of compulsory unionism do have a right to demand the repeal in the Taft-Hartley Act of the provisions sanctioning imposition of the compulsory union shop. ❁

## The New Orthodoxy

June 21, 1965

Because a paperback edition is now available of John Maynard Keynes' *General Theory of Employment, Interest, and Money*, first published in 1936, *The New York Times* invited John Kenneth Galbraith to write a front-page essay for its May 16 Book Review on the "revolution" that Keynes brought about in economic thought. Galbraith came through with a dozen columns.

It is a typical Galbraith performance. It hails "the Keynesian revolution" as "one of the great modern accomplishments in social design," and reveals for the first time that "it brought Marxism in the advanced countries to a total halt." Those who believe from reading their daily papers that there has been an unparalleled spread rather than a halt in socialistic thinking and policy in the last 29 years are apparently the victims of a persistent illusion.

Though Galbraith talks of the "fascinating obscurity" and "unique un-readability" of Keynes's *General Theory*, he proceeds to interpret its message with the utmost confidence. He assures us that Keynes's unintelligibility is a handicap, not to his disciples, but only to his critics. In fact, he scoffs at the very idea that there could be or has been any intelligent criticism of the *General Theory*: "Those who objected to Keynes were also *invariably* [my italics] handicapped by the fact that they hadn't (and couldn't) read the book."

### REFUTATIONS

I am very happy to assure the reader, nevertheless, that there have been some intelligent refutations of Keynesian doctrine. It would be immodest for me to refer to my own *Failure of the "New Economics"* (1959). But I can mention with much better grace the anthology I compiled in 1960, *The Critics of Keynesian Economics*, containing answers by more than twenty eminent

economists. And I can point with complete disinterest to the brilliant demolition by Prof. W.H. Hutt, *Keynesianism—Retrospect and Prospect*, which appeared in 1963.

Keynes initiated no "revolution" whatever in economics. What is original in his book is not true, and what is true is not original. Keynes merely developed a complicated rationale and a novel vocabulary to resurrect seventeenth-century mercantilism and the age-old nostrum of inflation.

Galbraith admits as much. The essence of the Keynesian remedy, he tells us, is to assure sufficient "aggregate purchasing power" at all times by "incurring a deficit." He even deplores the "double-talk" of those who say we can have both Keynesian policies and balanced budgets.

### PRINTING MONEY

Galbraith's candor stops only in failure to make clear (or even to understand?) that the increases in "purchasing power" brought about by deficits are merely increases in the number of paper dollars. But this must mean that each dollar will soon have a correspondingly lower purchasing power. If real purchasing power could be increased simply by printing more money, India and Africa would have nothing to worry about.

Galbraith does make one indisputable statement: "Keynesian policies are the new orthodoxy." They are practiced today by nearly every government.

What has been the result? There has been an almost continuous worldwide inflation. In the last ten years alone the German mark has lost 19 percent of its purchasing power, the British pound 26 percent, the Italian lira 27 percent, the French franc 36 percent and leading South American currencies from 92 to 95 percent.

In the United States we have had 29 deficits in the last 35 years. The dollar has lost 43 percent of its purchasing power even since 1945. Statistical studies show no correlation over the last 35 years between deficits and percentage of unemployment.

Meanwhile, Keynesian deficits, inflation and cheap-money policies have brought about a chronic deficit in the U.S. balance of payments. Government officials blame this not on their own policies but on American private business. Refusing to abandon those policies, the government imposes "guidelines" on wages and prices, and controls on tourists and investors. It is government addiction to Keynesian policies that made Federal Reserve chairman Martin's brave warning of June 1 so necessary. ❁



## One-Sided Compulsion

July 5, 1965

If Section 14(B) of the Taft-Hartley Act is repealed, it will be at least partly because most of the proponents of state right-to-work laws have been too timid. They have compromised their own principle. They have not fought compulsory unionism consistently. They have merely pleaded for the right of states to be allowed to enact or retain laws forbidding compulsory unionism. But they have tacitly accepted the Federal Taft-Hartley Act's explicit sanction of compulsory unionism.

This sanction flatly contradicts other provisions of the Taft-Hartley Act. In fact, it contradicts the professed purpose of the act. For the Taft-Hartley law makes it "an unfair labor practice for an employer . . . by discrimination in regard to hire or tenure of employment or any term or condition of employment to *encourage or discourage* membership in any labor organization."

As Prof. Sylvester Petro has written in his book *Power Unlimited* (1959):

"The fundamental principle of the Taft-Hartley Act is the principle of free employee choice. Employees are expressly declared to have the right to join or not to join unions, free of economic or physical coercion by either employers or trade unions. Naturally, all forms of compulsory unionism are inconsistent with that principle. If a man must join a union in order to hold his job, he is being subjected to the kind of economic coercion which the act generally makes an unfair practice. Yet, compromising this fundamental principle, Congress explicitly permitted unions to impose union-shop contracts upon employers and employees, at least in states where such contracts were not prohibited. From that compromise, together with the denial of direct access to the courts, the lethargy of the NLRB, and the Supreme Court's pre-emption theory, all the abuses associated with the nationwide prevalence of compulsory-unionism conditions have developed."

It follows that if Section 14(B) is now repealed, the opponents of compulsory unionism, instead of merely pleading for its restoration, should take the offensive and launch a campaign for repeal of the clause in Section 8(A3) in the Taft-Hartley Act which sanctions agreements imposing compulsory union membership as a condition of employment.

If the opponents of compulsory unionism take this course, they will be adhering to their principle consistently. They have weakened their position by accepting this clause and fighting a mere rear-guard action to keep in the act the 14(B) provision that implies the dubious doctrine of pre-emption. "A proper reading of

the U.S. Constitution," as Petro writes, "would suggest that the power of the states to prohibit all forms of compulsory unionism does not depend upon a specific grant by the Federal legislature. That power is, rather, inherent in the sovereign power of the states to protect their citizens from corrupt and criminal abuse."

### FREEDOM OF CONTRACT

Those government and union officials who want to repeal Section 14(B) on the ground of "freedom of contract" are insincerely using an argument that may boomerang on them. The principle of freedom of contract, they contend, requires that union membership as a basis of continued employment should be neither required nor forbidden by law. But if the principle does require that, it equally requires that *non*-union membership as a basis of employment should be neither required nor forbidden by law. Yet every union official insists on retaining the Taft-Hartley prohibition of the "yellow-dog" contract—a contract under which a worker agrees as a condition of employment that he will *not* join a union.

If union leaders insist on and get a completely one-sided law, which prohibits compulsory non-unionism while imposing compulsory unionism, they will arouse demands for the entire repeal of that law, and a restoration of the two-sided "freedom of contract" that prevailed before the Wagner Act of 1935, of which the Taft-Hartley Act of 1947 was an amendment.

Those who do not want such a restoration must in consistency agree to outlaw compulsory unionism everywhere as well as compulsory non-unionism. ☸

## Fallible Forecasting

July 19, 1965

There has long been a need for someone to keep score on the errors of the business forecasters. This is at last being done, systematically and on a broad scale, by the nonprofit National Bureau of Economic Research.

The task has been subdivided among several staff members. One of them is trying to find out how good have been the predictions of turning points in business. He is finding these "often difficult to interpret or evaluate because of vagueness or hedging." But another staff member, Victor Zarnowitz, had the easier task of comparing numerical predictions of the nation's gross national product (GNP) with what the official figures turned out to be.

He presents a tabulation on the results of eight sets of annual forecasts. Four of these are company forecasts,

another set groups those of 50 business economists. Altogether, the table records the efforts of 300 or 400 individual forecasters.

The errors in these eight sets of forecasts averaged nearly \$10 billion a year, up or down, from the actual figures for the eleven years 1953–1963 inclusive. The errors appear small—about 2 percent—when compared with the average level of actual GNP. But, as Zarnowitz points out, they are big enough to make the difference between a good and a bad business year.

### HOW TO COUNT ERROR

The average actual year-to-year change in GNP over the period was \$22 billion. Thus, as the study notes, the errors were not quite one-half the size of those that would have occurred by assuming that each year's GNP would be the same as the year before. Furthermore, the errors were almost as large as those that would have occurred by merely assuming that each year would show the same gain in GNP as the average gain in preceding years. Such an assumption would have gone wrong by an average of less than \$12 billion—only \$2 billion worse than the forecasts.

This, I think, is the valid way to count the percentage of error in a prediction. The predicted GNP should not be compared merely with the actual GNP, but also with the “automatic” prediction. By the automatic prediction I mean the figure that would result from taking the average percentage increase in GNP for, say, the last five to ten years, giving a little extra weight to later compared with earlier years, and making some allowance for the observed economic trend in the three months preceding the prediction. These are the kinds of figures that could be fed into an automatic computer. Then only if a prediction came nearer to the actual figure than did this automatic extrapolation would it deserve a compliment for insight.

### MISSING THE TURNS

As Zarnowitz puts it, though the simplest measure of error is obtained by comparing predicted with actual levels, it is more important to compare predicted with actual *changes*.

And the forecasts have persistently underestimated changes. They have turned out best in “normal” years, worst in abnormal years. They have also turned out worse for longer periods ahead than for shorter. To cite one example: in a semiannual forecast of GNP for 1955–63 by a large group of business economists, the mean errors of change were, for a six-month span, \$6.7 billion; for a twelve-month span, \$12.3 billion.

In brief, business forecasting is not yet an exact science. Nor will it ever be. We can't foresee the future by simply extrapolating from any number of figures or

trends in the past. There are too many “outside” factors that cannot be foreseen—droughts, floods, tornadoes, wars, revolutions, political decisions, sudden strikes. Estimates of the effects of other factors—monetary policy, deficits, tax changes, economic controls, labor-union demands—must involve a large element of guesswork. Most important of all, economic forecasts themselves affect the future they predict.

Yet to guide our decisions, we must all try to forecast. By intelligent study we may all hope to reduce the extent by and frequency with which our forecasts go wrong.

The aim of every speculator and businessman, however, is not merely to be right, but to be right *sooner* than his competitors. And that result no science can provide. ☼

## Do We Need More Money?

August 2, 1965

Secretary Fowler wants an international conference on money. His proposal is based on the fear that unless the world develops “a new and assured source of growing liquidity”—i.e., more money and credit—there may not be enough “to support increasing world trade and investment.” Nearly all the proposals now being put forward for an “improved” international monetary system are based on the same fear—that we are running out of money.

There is nothing new about such fears. In 1875, the British economist Jevons was writing: “In almost every country great complaints have from time to time been made as to the scarcity of the circulating medium, and the urgent need of more. All the evils of the day, the slackness of trade, falling prices, declining revenue, poverty of the people, want of employment, political discontent, bankruptcy and panic, have been attributed to the want of money, the remedy suggested being . . . the issue of paper money.”

The truth is that, except in a deflationary crisis, the existing amount of money is always enough to conduct the business of the country—for the simple reason that it is the existing amount of money that has determined the existing level of prices. If, with other conditions remaining unchanged, we increase the supply of money, each unit of money will be worth less than before. This means that prices will rise.

### NOT ENOUGH GOLD?

It is certainly true that, if the money supply is not increased while the economy is expanding, prices must

tend to fall. But a gradual fall of prices for this reason is to be welcomed rather than feared. Prices would be falling because the supply of goods was increasing. And real costs as well as money costs of production would be falling along with them. So profit margins (and therefore incentives to production and employment) would tend to remain relatively unchanged.

This situation has often existed historically. Wholesale commodity prices dropped from an index number of 84.7 in 1880, the year after this country returned to the gold standard, to as low as 60.5 in 1896. They had recovered to 73 by 1900 and in 1911 were still only 84.4 (1939=100). Yet this whole 30-year period, though marked by both depression and prosperity, was a period of continuous and strong economic growth.

The opponents of the gold standard argue that there simply isn't enough gold in the world to finance production and trade. So they want to supplement gold reserves with paper dollars or even with a new "composite reserve unit" of ten or eleven leading paper currencies. But if there isn't enough gold for reserves and money, why not use silver? Or if we can't spare silver at present, why not use copper? Or if there isn't enough copper, how about iron?

#### SCARCITY GIVES VALUE

Of course each unit of currency would then buy less. It is precisely because gold is scarce that it is valuable as money. It is precisely because its scarcity, unlike that of paper money, cannot be relieved by the mere whim or ukase of political managers that gold holds its value.

Increasing the supply of money is chasing a will-o'-the-wisp. Every increase in supply lowers the value of the monetary unit and raises prices. In the end, the bigger supply of money doesn't buy any more than, the smaller supply.

There is a shortage of gold in the world today only in one sense—that too much paper money has been issued against it, so that this paper money cannot be made freely convertible into gold at the old ratio. That is why so many people are asking for devaluation. But this would at best provide only temporary relief if the policy of currency and credit expansion continued.

In the twenty years of the International Monetary Fund system, the world has piled up a shameful record of inflation, depreciation and devaluation. Yet instead of demanding a return to balanced budgets and a true gold standard, everybody seems to be devising schemes to support still further inflation, under the Keynesian delusion that only constantly "increased purchasing power" through constant monetary expansion can assure prosperity. ❁

## Chaotic Anti-Trust

August 16, 1965

On July 23 a Federal judge fined eight of the nation's largest steel companies \$50,000 each on charges of conspiring to fix prices of carbon-sheet steel between 1955 and 1961. The judge also set Sept. 21 as the date of sentencing two of the steel executives—with possible penalties running up to a year in prison and \$50,000 personal fine. A few days later four steel companies and a trade association were fined a total of \$150,000 on charges of conspiring to fix prices on steel forgings.

Both cases were uneasy reminders of the fines and jail sentences imposed in 1961 on some officers of the biggest electrical-equipment companies in the nation.

These men were treated as common criminals. And for doing what? For doing precisely what millions of workers are not only permitted but sometimes compelled to do under the law—for setting noncompetitive prices on what they have to sell.

Let us suppose that the charges against the steel companies are true. (They pleaded "no contest"—which means that they were willing to accept punishment without admitting guilt.) How can the government or anyone else prove that on net balance economic damage was done? And how can anyone determine the extent of the excess costs to the steel companies' customers? (This is legally important, because any firm that felt it had paid too much for steel because of the alleged price-fixing could bring suit, and, if it won, would be entitled under the antitrust laws to treble damages.) But how can anyone determine how much the fixed price exceeded, if at all, what a "competitive" price would have been?

#### 'RESTRAINT OF TRADE'

Opening a broader issue, how can the amateur economists who sit as judges in the courts—or, for that matter, how can professional economists—determine whether there has been "restraint of trade," not to speak of determining how much restraint, when there has been no physical coercion or intimidation?

An extremely efficient firm, perhaps by discovering some improved product or cost-cutting method, may undersell all its competitors and drive them out of business, thus substituting at least a temporary monopoly for previous competition. Has it "restrained" trade? Has it made conditions worse—by offering consumers a better product at a cheaper price or better?

Such questions apply particularly to recent court decisions against mergers. Thus a Federal district court a few months ago ordered the dissolution of the three-and-a-half-year-old merger of the Manufacturers and Hanover banks as a "combination in unreasonable



restraint of trade.” Yet the merger had reduced the number of competing banks in New York City only from 72 to 71. The merged bank had only one-eighth of the assets of all New York City banks; and it was presumably able to compete more effectively than before with its two larger rivals, the Chase Manhattan and the First National City banks.

### DOUBLE STANDARD

The antitrust laws as at present interpreted are questionable both on economic and on legal grounds. No big business firm today knows exactly when or why it will be held to be violating them.

But if we hold that monopoly is always bad in itself and that government should promote the maximum of competition, how can we justify the policy we follow elsewhere? In the field of labor, our laws not only permit but in many cases enforce monopolistic wage-fixing. Employers are compelled to bargain exclusively with monopolistic union wage-setters. Compulsory non-unionism is illegal; but compulsory unionism is explicitly legal.

Our laws not only permit but enforce acreage restriction and hence price-raising in cotton, wheat, tobacco. Our international agreements permit export quotas and hence price-raising in coffee; and import quotas and hence price-raising in oil; and tariffs to hold up domestic prices.

Do our present antitrust laws rest on farsighted reasoning, or does our treatment of big business reflect a discriminatory vindictiveness? Isn't it time we reexamined our glaring double standard and contradictions of policy? ❁

## Put a Price on Water

August 30, 1965

As the drought in the Northeast approaches crisis proportions, Federal, state and city officials propose desperate measures to increase the water supply. President Johnson signs a \$185 million desalting-research bill and calls upon science and industry to develop plans for desalting plants to produce 100 million gallons a day—five years from now. But prior to last week's Delaware River agreement, New York officials feared that the city might run out of water before next spring. Mayor Wagner says the city has examined every proposal “from tapping the Niagara to sawing off a part of a glacier and floating it into New York Harbor.”

But increasing the supply of water is only one half the problem. The other half, about which something

can be done immediately, is to reduce wasteful consumption of water. New York has issued a series of emergency orders. Shut down all fountains. Don't flush streets. Don't refill swimming pools. Don't sprinkle your lawn. Don't wash your car. Don't even serve a glass of water in a restaurant unless it is asked for. The latest orders severely cut down on the hours for using air-conditioning units.

### EXHORTATION

Such rules are (to some extent unavoidably) arbitrary, inflexible and procrustean. They are creating conflicts. New York City's water supply department accuses its parks department of illegally watering its public golf courses at night. Parks Commissioner Morris retorts: “We shouldn't throw 20,000 players off the courses just because of a little bit of water. . . . I flush my toilet only about once a day now and I take a bath only every other day. If you figure up the water I save by giving up these things, you've got almost enough for the greens.” And people who work in a round-the-clock business in a modern building without openable windows wonder how many hours they will be expected to sweat or suffocate.

Of course there can be exhortation to the citizens to save water. There has been no lack of it. It is repeated every day. But there is a certain futility about it, and the reason is clear. The individual citizen knows that there is a water shortage. But he may reason: what I personally save will affect less than a millionth of the total consumption. What difference will that make? Moreover, he may darkly suspect that others are cheating—taking long showers, neglecting leaky plumbing, maybe letting the cold water run all night just to cool the room.

### EFFECT OF METERS

Yet while New York City officials are toying with all sorts of far-off, far-out schemes for increasing the water supply, they have until now ignored or rejected the simplest way to cut down the consumption—to charge everybody in proportion to the water he uses. Mayor Wagner admits that he has “always opposed universal metering in New York City,” but now his own study panel recommends it.

To install meters, as far as practicable, for every consuming family, would merely apply for water the same market principle and price system that applies nearly everywhere else. When anything—water, or food, or housing, or doctors' services or hospital care—is provided “free,” or below real cost, it is bound to be wastefully used.

Do New Yorkers waste water? Well, 8 million of them consume 1 billion gallons of water a day—about 125 gallons a person. As each person drinks less than a



gallon, there must be immense opportunities for saving in the other 124 gallons.

The knowledge that there was a meter ticking the pennies away would give a constant incentive for economy. Then each person could save water at the points where he himself thought he could best spare it. When water became scarce the rates could be doubled. Or a penalty surcharge could be put on anything above a basic allowance per person.

Ten years ago, 73 percent of Philadelphia's water was delivered through meters and the city consumed 400 million gallons a day. Today, with 100 percent metering, Philadelphia uses only 325 million gallons a day.

The moral is obvious. People economize on what they pay for. ❁

## Rule by Guideline

September 13, 1965

A few months ago, George Champion, chairman of the Chase Manhattan Bank of New York, expressed his alarm over the trend in Washington toward what he called "government-by-guideline." There are guidelines for wages and prices, guidelines for antitrust enforcement, for labor-management behavior and for television advertising. And bankers have been given a special set of guidelines for the balance of payments and for lending rates.

This trend operates behind a façade of friendliness and partnership between government and business, accompanied by much talk of "reasoning together" and "voluntary restraint." "But always in the background," said Champion, "is the subtle threat that failure to comply with the guidelines voluntarily will bring sternly coercive measures—measures applied, for the most part, without public debate in the halls of Congress or legal appeal in the courts."

Most of these guidelines are misconceived economically. Yet the whole trend toward government by guideline is based on the assumption that bureaucrats know more than the market. This trend, Champion concluded, "is one of the most insidious and dangerous on the national scene today."

### ANOTHER 'REQUEST'

Since he made his speech, government-by-guideline has shown, unfortunately, no signs of slowing down. On Aug. 18, for example, the White House reported that whereas consumers had received the benefit of about three-fourths of the \$1,750,000,000 excise tax reduction enacted two months earlier, some manufacturers (e.g., of phonograph records, pens, pencils and

matches) had failed to pass along the reduction. This failure, added the White House press secretary, "bears closer examination." Meanwhile the government would "request these manufacturers to keep faith with the hope of the Administration and Congress in passing this legislation and to pass on the benefits."

Here is a perfect specimen of the government-by-guideline technique. Everything is to be "voluntary"; manufacturers are "requested," not ordered. But if they fail to do what the White House wants, there is a thinly veiled threat that something unpleasant will happen to them, even though the government has no legal right to force any price-tag reduction.

Apart from its disturbing legal implications, the White House statement is economically naïve. Manufacturers do not, as the statement implies, pass along a tax cut in full because they are public-spirited fellows, or fail to do so because they are selfish profiteers. In both cases it is costs, consumer demand and competition that decide final prices, just as they did before the tax was reduced. In the lines that failed to "pass on" the full tax cut, an upward price adjustment may have been overdue. The White House statement implies that prices and profit margins in each line were just what they should have been before tax cuts.

### POWER CREATES POWER

How does the government come to have the power to impose guidelines over business decisions that it has no explicit legal authority to control? The answer is simple, and may be stated in the form of a political law: when a government has too much power in any direction, it can easily use it to usurp more power in other directions.

For example, the Federal government now spends one dollar out of every five now spent in the United States. Many business executives fear to oppose even unauthorized government "guidelines" for fear that they will lose government contracts, or have existing ones adversely renegotiated. Or they fear that they may suddenly be prosecuted for violating one of the vague and contradictory antitrust laws. Or they fear that their income tax may be hostilely examined. Or they fear that they may be cited for violating Federal labor laws.

In all these cases enormous discretionary powers rest in the hands of government officials. Even if an Administration never abuses these powers, and never uses them for economic reprisal, the mere fear that it may do so is enough to intimidate most businessmen. A government can usurp still more power precisely when it already has too much power. ❁

## The Effort of Every Man

September 27, 1965

“No ordinary misfortune, no ordinary misgovernment, will do so much to make a nation wretched as the constant progress of physical knowledge and the constant effort of every man to better himself will do to make a nation prosperous. It has often been found that profuse expenditure, heavy taxation, absurd commercial restrictions, corrupt tribunals, disastrous wars, seditions, persecutions, conflagrations, inundations, have not been able to destroy capital as fast as the exertions of private citizens have been able to create it.”

So, in the mid-nineteenth century, wrote Thomas Babington Macaulay in the chapter of his famous *History of England* describing the state of the country in 1685.

It could easily be proved, he went on, that the national wealth of England had been almost uninterruptedly increasing for at least the six preceding centuries. For example, “in spite of maladministration, of extravagance, of public bankruptcy, of two costly and unsuccessful wars, of the pestilence and of the fire, it was greater on the day of the death of Charles the Second than on the day of his Restoration.” And this economic progress had been proceeding during the nineteenth century with “accelerated velocity.”

### CLAIMING THE CREDIT

Macaulay was calling attention to a fact of the first importance, but one that is constantly overlooked. It is systematically ignored today by nearly all governments, who are, at least by implication, constantly claiming for their own policies all the credit for all the economic improvement during their term of office.

This has been especially true since gross-national-product statistics have been compiled. Spokesmen for the Truman Administration boasted that the GNP increased from \$211 billion in 1944 to \$347 billion in 1952. Spokesmen for President Eisenhower pointed to the increase to \$503 billion in 1960; spokesmen for President Kennedy to the increase to \$584 billion in 1963; and spokesmen for President Johnson to the increase to \$670 billion in 1965. But it remains to be determined to what extent these increases (even after allowance is made for a constant rise of dollar prices) were because or in spite of the government policies followed.

Most European governments boast an even faster “economic growth,” since the end of World War II, in their countries than in our own. But by far the greatest part of the credit for this growth must be given to the efforts of private citizens of these countries to improve

their own condition. If the governments also deserve some credit, it is chiefly because they did not put too many restrictions and deterrents in the way.

### USUAL AND EXPECTED

The great fact that Macaulay emphasized, “the constant effort of every man to better himself,” is important not only as it affects the question of who or what should receive the main credit for economic progress. It is the tremendously reassuring fact that all of us would do well to keep in mind as we read our daily newspapers. Too many of us become disheartened anew every morning as we read the sorry record of accidents, divorces, quarrels, unemployment, diseases, deaths, burglaries, muggings, murders, riots, looting, racial violence, strikes, fires, revolts, revolutions and war, as well as droughts, floods and other natural disasters. We forget that the newspapers print the “news,” and that the news means the unusual and unexpected.

We do not pick up our newspaper and read such items as “Strange case of virtue in the Bronx” or “More than 70 million people all over the United States went to their jobs yesterday morning, working in factories, offices and on farms till late afternoon. The police did not interfere.” We do not read such items because they are the usual and the expected.

The normal thing, in short, is not merely that most people are leading peaceable lives, but that most people are daily working and producing. Many are producing just enough to meet their current living expenses, but others are able to save something—in brief, to accumulate the capital, the money to create the new tools and equipment, that will make not only themselves but later generations constantly more productive. ⚙

## Inviting Strikes

October 11, 1965

The newspaper strike in New York City (after the 114-day strike of 1962–63 that helped to put one newspaper, the *Daily Mirror*, out of business) is one more example of the increasing tendency of unions to make excessive demands whose acceptance would be not only against the long-run interests of the economy, and therefore of the great body of workers, but against the long-run interests even of the majority of union members themselves.

One of the demands of the Newspaper Guild on *The New York Times* is the compulsory union shop—though 2,200 out of 2,400 eligible employees are already on the union rolls. This would mean that *all* stories about labor disputes would be written by union members. The

compulsory union shop, moreover, is against the interests of every worker considered as an individual. He cannot get employment unless he is a member of the union; and he is not free to leave the union (except at the cost of his job) if he is dissatisfied with the way it is being run.

The main issue that gave rise to the strike is automation. The guild is asking that no man be fired because of automation and that the guild have a veto on the introduction of any labor-saving machine that could place work performed by a guild member under jurisdiction of another union.

### VETO ON PROGRESS

Now a veto on automation is a veto on progress. It forces work that could be done more efficiently and with less labor to be done more expensively, less efficiently, and with more labor. In the long run such a veto does not make more jobs but fewer. By depressing the average productivity of labor it correspondingly holds down the average level of wages. What it protects (temporarily) is a continuance of a few specific jobs that already happen to exist. But it does so only by preventing the creation of more productive jobs. It continues Peter's present job only by closing off Paul's, or his own, future job.

In the New York newspaper strike, wages are not an issue. But they have been the principal issue in practically all other major union negotiations this year. Labor costs have already been raised on New York newspapers to such an extent that most of them are losing money and one or two more may be driven out of existence.

When a union succeeds in driving wage rates or costs above the marginal productivity rates that a free market would establish, it merely cuts the number of jobs that would otherwise be available. Unions cannot raise real wages above what they otherwise would have been without cutting employment below what it would otherwise have been. Unions cannot raise the *general* level of real wages; they can at best raise some wages at the expense of others. This result is usually disguised from the general public by the fact that constant increases in man-machine productivity lead to increases in most wages. But the unions—to the extent that they reduce production by work rules, featherbedding and delaying automation—reduce wages below what they would otherwise be.

### DOUBTFUL LABOR LAWS

The recent costly strikes and "wage-inflation" resulting from strikes have led to proposals that industry-wide unions be prohibited, or even that strikes be prohibited, and that all disputes be submitted to compulsory arbitration. All such proposals are in the totalitarian

direction, and they would in fact create more problems than they solved.

But before the situation becomes still worse, it might be a good idea to take a hard look at the wisdom of the labor legislation that we began passing in the 1930s, and at local law-enforcement attitudes. We might remove, for example, some of the present one-sided compulsions on employers to bargain exclusively with specified unions and some of the one-sided immunities to unions which enable them, through picketing and other forms of intimidation, to force a business to shut down until it has yielded to their demands. Under present laws and rulings, a company hardly dares to warn strikers that it will permanently replace them with other workers and carry on its business. The laws invite strikes both by taking the major risks out of them for strikers and multiplying the risks of employers who try to combat them. ☸

## A World Money Plan

October 25, 1965

At the end of September the International Monetary Fund held its annual meeting in Washington and celebrated its 21st birthday. Secretary Fowler happily announced that the fund had been broadened this year by the addition of Malawi and Zambia. The delegates of the 103 nation-members made speeches. Nearly all of them said that the IMF monetary system has been working very well but is in urgent need of reform.

The system has, of course, been working very badly. The last twenty years have been years of disgraceful world inflation. In the last ten years alone the German mark has lost 19 percent of its purchasing power, the British pound 26 percent, the Italian lira 27 percent, the French franc 36 percent and leading South American currencies from 92 to 95 percent. The keystone of the system has been the American dollar. It has lost 43 percent of its commodity-purchasing power since 1945.

Plainly reform is urgent. But nearly every proposal for reform has been in the wrong direction. Each wants to create more "international liquidity," which in English means more paper money. President Johnson says that what is needed is "the creation of additional reserves." Secretary Fowler adds: "We can hardly expect that . . . the world can be satisfied very long to limit future growth in reserves to the very modest level of new monetary gold supplies."

If this means anything, it means that the new "reserves" are to consist of paper money.



## DISGUIISING INFLATION

Well, why can't each country simply print whatever additional paper money it thinks it needs? The reason is that naked inflation is in disrepute. But techniques that disguise it are still fashionable. For the last twenty years the United States has been printing additional paper dollars and sending billions of them abroad. These exported dollars do not put up the prices of American goods; and so our authorities can say that "there has been no (or very little) inflation." But the dollars do put up the prices of the foreign goods they buy. In addition, our dollars end up as "reserves" in the central banks of other countries. Against these "reserves" the other countries print additional amounts of their own currency. Though this brings on inflation in these countries, it is all considered very respectable.

In still another way the IMF system encourages world inflation. When a country creates a deficit in its balance of payments through its own unsound policies—too much paper money, budget deficits, holding down interest rates, pegging its currency at an overvalued level—it can borrow from the IMF. Or other countries combine to make it a loan. By being continually rescued the monetary sinners are encouraged to continue their sins.

## DISSOLVE THE IMF

To the scores of existing plans for international monetary reform I should therefore like to add another. It is the opposite of nearly all the rest. Dissolve the IMF. Or at least make it stop all forms of automatic or easy-to-get credit.

As Karl Blessing, president of Germany's Bundesbank, said in the most realistic speech at the IMF meeting: "If a country enjoys confidence, it can obtain credit from anywhere; if it does not enjoy confidence, it must, first of all, adopt measures to regain this. I cannot help thinking that too perfect a machinery for financing balance-of-payments deficits weakens monetary discipline and contributes to creeping inflation."

After the IMF had been dissolved (or had at least halted all no-questions-asked credit or soft loans), each nation would be forced to see both the advantage and necessity of returning to sound money. It could do this by (1) halting any further increase in its paper-money supply; (2) by letting exchange rates go free, and ceasing to try to maintain an artificially pegged value for its currency either by prohibitions on its citizens or by government intervention on the foreign-exchange market; and (3) finally, by making its currency, perhaps in several stages, directly convertible into a fixed amount of gold.

This would restore international cooperation in currency stability instead of the present system of central banks cooperating in inflation. ☸

## Dilemma of Foreign Aid

November 8, 1965

In 1947, in a book on foreign aid, *Will Dollars Save the World?*, written when the program was first launched, I pointed out that intergovernmental loans and grants "are on the horns of this dilemma. If on the one hand they are made without conditions, the funds are squandered and dissipated and fail to accomplish their purpose. . . . But if the lending government attempts to impose conditions, its attempt causes immediate resentment. It is called 'dollar diplomacy'; or 'American imperialism'; or 'interfering in the internal affairs' of the [recipient] nation."

In the eighteen expensive years since then, the champions of foreign aid have persistently ignored or denied the existence of such a dilemma. But in practice they have swung uncertainly from one horn to the other—imposing conditions, dropping them when criticized, silently watching the aid funds being misused, then trying to impose conditions again.

And today, two decades and \$115 billion later, the danger is that the dispensers of our foreign aid will follow the worst policy of all—imposing conditions, but exactly the wrong conditions.

In signing the new \$3.2 billion foreign-aid bill, President Johnson declared that our future foreign aid will go to those countries "willing not only to talk about basic social change but who will act immediately on these reforms."

## 'LAND REFORM'

The next day Senator Aiken of Vermont indicated the nature of the "reforms" that our aid dispensers want. "American aid," he said, "was based on an assumption that there would be substantial amounts of self-help—that the rich of a poor nation would invest in their own economies, that they would pay their taxes, that they would support land reform and show some interest in the poor of their own societies. This has proved largely a false expectation."

What Washington apparently now has in mind is to ask of the countries that receive our foreign aid, not that they give guarantees of the security of property, the integrity of their currencies, refrainment from crippling government controls and encouragement to free markets and free enterprise, but that they move in the



direction of the welfare state, the redistribution of land and other wealth and government planning.

When Senator Aiken and others demand “land reform,” precisely what are they asking for? Do they mean the breaking up of big estates, with inadequate or no compensation, and the redistribution of land to the peasants? Have they studied the recent history of most such “reforms” in Mexico, for example—and how and why they have been followed by less food production rather than more? When the senator complains that the rich in a poor nation do not “invest in their own economies” but place their funds abroad, has it occurred to him to ask why they do so?

### WHY FUNDS GO ABROAD

If he asks them confidentially, they will tell him. Abroad, they are free to choose their investments. They are free to look for the best returns. They are not subject to excessive taxation. They are not holding a currency that is constantly falling in value. (In the last ten years the currency of the Argentine has lost 92 percent of its purchasing power; the currency of Chile has lost 94 percent; of Bolivia 95 percent; of Brazil 96 percent.) The rich in most such countries live in constant fear of expropriation. Will “land reform” reassure them?

In the last twenty years foreign aid may have made American taxpayers \$115 billion poorer, but it has not made the recipients that much richer. The funds have not gone into the most productive ventures, but largely into grandiose but wasteful socialistic projects.

If our economic aid were tapered off, the poor countries would have to try to attract private investment, both domestic and foreign. They would have to give guarantees that capital and profits could be repatriated, and guarantees against currency exchange restrictions, against discriminatory taxation, price and profit controls, government-owned competition and above all against expropriation.

And the government that reluctantly gave such guarantees would be amazed to find how suddenly its country would begin to prosper. ❁

## Great Society's Cost

November 22, 1965

The last session of Congress passed bill after bill to enact the Great Society, the complete welfare state. It gave something to everybody. Major programs included medicare, the war on poverty, aid to Appalachia, foreign aid, aid to local elementary and high schools, aid to colleges, aid to farmers, aid to cities. Congress

voted money for public health, for economic development, for public housing, for work-training programs, for adult education, for control of water pollution and air pollution, for making salt water into fresh water, for a National Foundation on the Arts and Humanities, and so on and on. It authorized rent subsidies for low-income families, but postponed an appropriation.

The first year's money-cost of each of these programs was often specified, and sometimes even the rising cost in later years. But neither Congress nor the Administration has so far bothered to put the total cost together, even for the first year, let alone the next five.

### SIZE OF THE BILL

That total cost will be high. Senator Dirksen made public a compilation by the staff of the Republican policy committee of just 50 examples of authorizations and appropriations passed in the last session. The total cost of these, over the next five years or so, came to more than \$112 billion. *The New York Times* reports that total Federal government spending will rise a minimum of \$10 billion and a maximum of \$13 billion in the calendar year 1966 over 1965. Still another unofficial estimate is that total cash Federal spending will rise to \$130.2 billion in the current fiscal year ending next June 30 (as compared with \$122.4 billion in the 1964–65 fiscal year), and to \$143 billion next fiscal year.

Where is the money going to come from? Who is going to pay for the Great Society—and when? There is no evidence that either the Administration or Congress has so far paid any attention to these questions.

Let us suppose that we miraculously resolved to return to balanced budgets, and to pay as we go for the Great Society. How much would taxes have to be increased?

Last January the President estimated total cash receipts for the current fiscal year at \$123.5 billion. Just to pay for this fiscal year's \$130.2 billion would mean raising \$6.7 billion more. To pay for next year's expenditures we would have to raise \$19.5 billion more. Over the last five years tax revenues have risen an average of \$2.8 billion a year in the administrative budget, and an average of \$4.7 billion a year in the total cash budget. But even if we assume that they will rise \$5 billion next year, we would still have to raise about \$14.5 billion more by more taxation.

### WHO WILL PAY?

How and where would we get it? Let's look at our four main revenue sources, which together raise 87 percent of all our tax receipts. Personal income taxes are officially estimated to bring in \$48 billion this fiscal year. The tax rates in excess of 50 percent, however, have been bringing in less than \$250 million a year—not enough to run

the government for a full day. If raised they would probably yield even less. More money would have to come from increases in rates on middle and lower incomes.

The corporation tax yields less than \$28 billion. It already takes nearly half of corporate income. If raised it would further penalize and discourage production. Excise taxes yield less than \$14 billion. Even if restored to previous levels they would only yield about \$1.7 billion more—and of course discourage sales and output. Employment taxes yield less than \$19 billion. They will certainly be raised; but they fall proportionately on the lowest incomes, and force the poor to pay for their own welfare benefits.

If our Federal government were bound by the restrictions of many foreign governments, and of some of our states, and were forced to accompany every new spending bill with a new tax bill to raise the money for it, so that everybody knew who was paying as well as who was getting, there would be considerably less enthusiasm for the Great Society.

The current delusion is that the cost will come out of some fourth dimension. But there is strong reason to suspect that in the long run the anti-poverty program will create more poverty than it relieves. ❁

## Garroting by Guideline

December 6, 1965

It is hard to say whether it is the legal and political or the economic implications of the government's recent adventures in price-fixing that are most disturbing.

The Administration has no legal authority from Congress to fix prices. Yet by public threats to use its huge stockpiles to flood and depress the market (and also, according to some published accounts, by off-the-record threats of antitrust action, income-tax review and shifting of defense contracts) it has succeeded in forcing the aluminum and copper industries to roll back announced price increases.

Nor did the government state clearly in advance, nor has it stated yet, precisely what its price-fixing standards are, so that an industry or a particular firm may know when it is "violating" them, and by how much.

The best things we have to go by are the government "guidelines" for wages and prices. These turn out to be either very vague or very rigid, depending upon who happens to be involved. If one could state the guidelines as general rules, they would run like this: "Wages in any industry should rise no faster than the national average gain in output per man-hour, or 'productivity'

(which the government says is 3.2 percent a year); and prices should not go up at all."

### ECONOMIC NONSENSE

If we begin to count up even the government's own "exceptions" to this, the guidelines dissolve into mist. And if we take a realistic look at the general rule itself, it turns out to be economic nonsense.

Even if we accept the government's questionable average productivity-gain figure, it is obviously absurd to make the wage increase of an individual worker, or even of all the workers in a single industry, equal to the *national* average gain in "productivity." For the "productivity" increase of some workers may be far higher than the national average, and the "productivity" increase of other workers far less. Why should all get the same increase? This would not only be unjust but would retard the flow of workers to the industries where they are most needed.

Again, the "man-hour productivity" that the Council of Economic Advisers "measures" is really man-machine hour productivity. It is not "labor productivity" but the combined productivity of labor and capital; and it has been rising each year not because workers annually work harder but because more and better equipment is put into their hands. If the whole increase went to the workers, and none to the capital investment that made the increased productivity possible, the capital investment (and the increased productivity) would cease.

### PRICES ARE GUIDES

Still more absurd is the attempt to hold every price just where it is. The government is trying to apply the Procrustean rule to steel, aluminum and copper, though conditions are radically different in the three industries. Aluminum, for example, even if its price increase had been allowed to stick, would still be selling below its price five years ago. The industry's return on net worth in 1964 has been calculated at 7.4 percent as compared with a 12.7 percent average for all U.S. industry.

The government's rigid rule overlooks the whole function of prices in a free economy. Prices are an indispensable guide to producers. The relative profits and losses they lead to determine the ever-changing balance of production among thousands of different commodities and services. It is always harmful to freeze prices. Prices have work to do. Each individual price must be free to tell the truth about conditions in its industry. Government bureaucrats do not know what the price of anything, let alone the price of everything, ought to be. Only the free market, only the unceasing play of supply and demand and competition, can decide. Price-fixing can only choke and disorganize production.

The real author of inflation is the government. It has been averaging an annual cash deficit of \$4 billion for the last six years. It has been pushing down interest rates. It has been increasing the money supply recently at an annual rate of 8 percent. It has cheapened the dollar. And now it tries to divert attention from its own inflation (which it calls “expansionary” policies) by making industry the scapegoat. ❁

## Fixing Interest Rates

December 20, 1965

The action of the Federal Reserve Board in raising the discount rate from 4 to 4½ percent was necessary to head off a further inflation. So far from being premature, as suggested by President Johnson, the step was overdue. Interest rates have already been held down by government policy too much and too long.

In a free economy every price has a vital function to perform. That function is to register the state of supply and demand, to guide the economic actions and decisions of all of us, to maintain a constantly balanced and synchronized output of thousands of different commodities and services. Government price-fixing can only misguide and dislocate production.

If there is one price in the economy that is more important than any other it is the interest rate. This is popularly thought of merely as the cost of borrowing “money.” Some economists have called it, more broadly, the price paid for the services of capital. It would be much better to call it the price of *time*. It is the discount on future goods as against present goods. It affects the price of all securities and all price relationships. The interest rate determines the relative production of capital goods as compared with consumption goods. It affects how much people spend of their income, how much they save and invest and where they invest it.

### A COMPETITIVE PRICE

The market rate of interest—or, more realistically, the constellation of market rates of interest—is extremely competitive and fluid. There are more than 14,000 banks in the country, all in daily competition with each other for customers. It is preposterous to assume that they could all conspire to fix any interest rate or set of interest rates. Anybody with cash is free to decide at

any moment to become a lender. Interest rates fluctuate daily and hourly in the markets of the world.

And yet the President’s economic advisers presume to know better than the market exactly how high interest rates ought to be. Mr. Johnson recently indicated that he would be gravely displeased if banks raised their “prime rate” to their best customers above 4½ percent. Secretary Fowler solemnly declared that any increase in interest rates would be “premature and unwise.”

How do government officials get that way? They get that way because they and their advisers have come to believe devoutly in the theories of the late Lord Keynes. According to Keynesian theory it is properly a function of government, and not of the market, to fix interest rates. And it is likewise always the government’s duty to fix interest rates very low. The theory is that low interest rates encourage borrowing, investment and full employment.

### CAN'T GO ON FOREVER

One thing the theory overlooks is that arbitrarily low interest rates discourage saving. This does not bother the Keynesians because they forget that what is being borrowed and lent is ultimately real capital. They assume that the only thing involved is “money”—and more paper money can be printed at will. Therefore, if you want to push down interest rates all you have to do is increase the supply of money and credit. So Federal Reserve policy had been increasing the money supply in recent months at an annual rate of 8 percent.

It is true that, under certain conditions (such as we have had for the last five years), cheap money and currency expansion can bring about a temporary boom. But the process in the end defeats itself. The increased money supply raises prices and costs. Expectations of further increases in the money supply then cause an *increase* in interest rates to compensate lenders for an expected fall in the purchasing power of money. (As the cost of living has increased 1.8 percent in the last twelve months, a government bond with a money yield of 4.2 percent has had a real yield of only 2.4 percent.)

Our artificially low interest rates, our budget deficits, our rapid expansion of the money supply have been the basic causes of the rise in prices and costs, the deficits in our balance of payments and waning faith in the dollar. The increase in the discount rate was a step in the right direction. Let us hope that the inflationists in Congress or the Administration do not nullify it. ❁

1966





## Manipulating Money

January 3, 1966

The action of the Federal Reserve Board in raising the discount rate from 4 to 4½ percent on Dec. 5 touched off a string of controversies. Let us look at three of the main questions it raised.

1—Was the Fed justified in raising the money rate?

Yes. Failure to act, or even further delay, would have touched off a dangerous inflation. The question may be raised, in fact, whether the action went far enough. It was accompanied by official assurances of “continued provision of additional reserves to the banking system, in amounts sufficient to meet seasonal pressures as well as the credit needs of an expanding economy.” How will this be translated into action? If the Fed continues to expand the money supply as rapidly as in the recent past, it can nullify its discount-rate increase.

2—Should the Federal Reserve Board be independent, or should it be forced to “coordinate” its money and credit policies with those desired by the Administration in power?

Clearly the Reserve Board should be independent. The government in office should not have the power to dictate or overrule its decisions. This was the express intention of Congress in setting up the Reserve System. This is precisely why the seven governors of that system are appointed for overlapping terms of fourteen years each. Without this independence the interest rate, and money and credit, would become the direct playthings of politics. For the politicians in power not only want perpetual prosperity, full employment and “economic growth,” but they are convinced that these can only be brought about by continuous cheap money and currency expansion—in other words, by chronic inflation.

During and after World War II, when the Treasury was allowed to dictate, it forced the Fed to create billions of new dollars to buy its bonds. Other illustrations were seen in recent weeks when the inflationists in Congress “investigated” the Reserve Board for raising the discount rate, when the President “regretted” its decision, and when the Secretary of the Treasury voiced the extraordinary opinion that higher interest rates here would probably do nothing to stem the flow of dollars abroad (a chief reason why it was done), but would simply lead Europe and Japan to push their own interest rates even higher. “Long before we could level rates here and abroad through this process,” the Secretary asserted, “we would drive this country into a recession.” His own theory seems to be that interest rates are not determined by market conditions but solely by government money managers; and that foreign governments

have a suicidal desire to push up interest rates at home to recession-creating levels.

3—Should governments be in the business of fixing interest rates and manipulating the money supply?

This is the first question that ought to be raised rather than the last. If the Fed is forced to “coordinate” its policies with those of the Administration in power the outcome is almost certain to be chronic inflation. But the dilemma is that if the Fed tries to act independently the result may be dangerous discoordination. The Fed cannot put its foot on the brake while the Treasury puts its on the gas. If the Treasury runs a chronic deficit it leaves the Fed no choice but to buy and monetize government securities.

When government officials are in the business of manipulating interest rates and the supply of money, everyone has a different opinion of what they ought to do. The Fed governors cannot agree even among themselves; their vote on the discount-rate increase was 4 to 3. A thousand “monetary economists” voice a thousand different opinions as to the exact “timing” and “policy mix” that are called for—what interest rate, what size budget deficit, what open-market operations—and when. To apply the proper mix and timing all we have to be sure of is the future.

But none of these insoluble problems arises if we stop assuming that it is the function of government to fix interest rates and to manipulate the money supply. Its function and duty are to maintain the integrity of the currency unit at all times (by, say, keeping it always convertible into a fixed amount of gold). It should leave interest rates to the market. ☸

## LBJ'S Budget Dilemma

January 17, 1966

For the last five fiscal years, the government has been run at a continuous deficit. Spending has been increased year by year. In the current fiscal year it is expected to exceed \$105 billion, some \$24 billion more than in fiscal 1961. In addition, substantial tax cuts have been enacted. The result has been an annual deficit averaging more than \$6 billion.

This fiscal record has been accompanied by five years of uninterrupted boom. And the boom, following the tenets of the “new economics,” has been attributed to the fiscal policy.

But now Mr. Johnson finds himself confronted with an embarrassing dilemma. The cost of the war in Vietnam is mounting ominously. This comes on top of the scores of Great Society programs rushed through

Congress last year. These alone, if uncurbed, could call for \$10 billion more spending in the next fiscal year than in the current one. Even in the current fiscal year the deficit is expected to reach \$8 billion. With the economy already overheating, with labor shortages in many lines, with consumers' prices every month going to a new high record, how big a deficit can be tolerated in the next fiscal year, without letting loose a serious inflation?

For in a situation like the present one even orthodox Keynesianism prescribes that "expansionary" policies should be terminated, if not thrown into reverse. This means not only that the recent \$6 billion average annual deficit must not be allowed to grow, but should be completely wiped out.

### UNPALATABLE COURSE

But *politically* such a course would be not only unpalatable but almost unthinkable. If the Great Society expenditures are not forthcoming or are drastically curtailed, there will be a deafening outcry from the favored groups to which they have been promised. The political loss to the Johnson Administration will be far greater than if the subsidies had never been proposed. Should taxes be raised, then—say by canceling the tax cuts made in the last two years? This would be politically even more repugnant. As the tax cuts were proportionately greatest on the lower incomes, the argument would be made that the little fellows were the biggest victims of the tax restoration. Besides, the public was told that a tax cut is the way to *increase* revenues. Can it now be persuaded that a substantial tax-rate boost will really bring in the needed added revenue?

### NEVER TIME TO BALANCE

The present dilemma is the inevitable product of past fiscal philosophy and practice. In the 1930s it began to be said that those who asked for an annually balanced budget were ridiculous "puritans" preaching an outmoded orthodoxy. The new slogan was a "compensated economy." The budget was to be balanced only over the "business cycle." There were to be deficits in all the bad years and balanced budgets or surpluses only in the good years. But it soon turned out that hardly any year was considered good enough in which to risk even a balanced budget, let alone to achieve a compensating surplus. To plan for a substantial surplus was considered fiscal folly. Even to balance the budget was to invite a dreaded "fiscal drag." So the only answer left was continual deficits.

If this doctrine was not invented by the politicians, it exactly suited their needs. They adopted it with alacrity. That is mainly why we have had 30 deficits in the last 36 years. Nothing is more popular than voting big handouts from the public till to innumerable pressure groups. Nothing is more unpopular than raising taxes

to pay for them. If Congress (like some of our state legislatures) were obliged to accompany every proposed new appropriation with higher taxes to pay for it, our Federal nondefense expenditures today might not be half as large as they are.

Nothing breeds fiscal irresponsibility faster than cutting the connection between expenditures and taxes. There is no real watchfulness over increased expenditures when nobody is being asked to pay for them, when they are going to be paid for by "the other fellow" in the sweet by-and-by.

The policies promoted by the "new economics" are not only unsound in all their economic assumptions; they are politically demoralizing. We shall soon learn whether they are also politically irreversible. ⚙

## The Right to Replace

January 31, 1966

The New York transit strike was handled with incredible ineptitude; but the Transit Authority and the new mayor were not solely to blame. They operated in an ideological climate and in a legal framework that made sensible action difficult.

If the strike had occurred in a different atmosphere (like that, say, in 1919 when Calvin Coolidge broke the Boston police strike) we can imagine a vastly different official attitude. The city authorities would have announced at the very beginning their determination to keep the buses and trains running. They would have immediately hired drivers for the buses and motormen for the trains, offered them permanent employment and given them police (or even National Guard) protection. Strikers would have been considered as having quit their jobs, and would have had to apply individually for reinstatement.

If such an announcement had been made before the strike deadline, it is unlikely that the strike would have been called. Even if it had been, it is probable that the city would have had buses running the first day and some trains within two or three days. Either the strike would have collapsed or the union would have quickly accepted a much more reasonable settlement than it did.

### FEAR OF VIOLENCE

Instead, a disastrous strike was allowed to paralyze transportation for twelve days, and to inflict hardship and suffering, and losses estimated at \$1 billion, most of them irrecoverable, on the people of New York. In the end, the strikers were handsomely rewarded for their callousness and defiance of law by the most extravagant

and costly wage increase in the city's transit history—an increase that went far beyond what they would have got if they had not struck. And what is most amazing is that the obvious course of keeping at least the buses running never publicly occurred to the mayor or the Transit Authority.

The chief reason why this straightforward course was not taken was never mentioned. The city authorities feared vandalism and violence on the part of the strikers. For the strikers set up picket lines, the very purpose of which was to prevent anybody else from taking the jobs that they themselves had vacated. Their right to do this was not questioned.

It was not always so. In earlier days a realistic judge would decide that picketing in numbers, so far from being peaceful exercise of free speech, “tends, and is designed by physical intimidation, to deter other men from seeking employment in the places vacated by the strikers. It tends and is designed to drive business away from the boycotted place, not by the legitimate methods of persuasion, but the illegitimate means of physical intimidation and fear.” (Judge Henshaw in 1909.)

#### **FREED TO INTIMIDATE**

And only last June, Enoch Powell, one of the leaders of the British Conservative Party, declared: “[British] law permits things to be done in furtherance of a trade dispute which would be criminal or would give rise to a right to damages if they were done in any other circumstances. . . . Private coercion of the trade union rests [on] the freedom to intimidate—technically this is called peaceful picketing, but it is what you and I call intimidation—the freedom to damnify another person with impunity; and the immunity of trade unions from action of tort—all provided the acts in question are in ‘contemplation or furtherance of a trade dispute.’”

The American legal situation is in some respects even worse. Yet one-sided laws, and the fear of violence, are not the only reasons why steel mills no longer attempt to keep operating during a strike, why newspapers don't dare to publish and why New York City did not even try to keep its buses and subways running. A confused public opinion must also take part of the blame. Union propaganda has succeeded in making “strikebreaking” the most wicked crime on the calendar. But if no strike can ever be broken, the strikers must always win, no matter how extravagant their final demands, and more and more strikes, with consequent economic paralysis, must be encouraged and rewarded.

If the New York transit strike at last causes a realistic reappraisal of law and opinion on picketing, it may have been worth its cost. ❁

## **Irresponsible Budget**

February 14, 1966

If we accept the budget on its face, it is better than the country was led to fear. Administrative spending is put at \$112.8 billion, instead of \$115 billion, and the budget deficit is put at \$1.8 billion, which would be the smallest in seven years. Yet even \$112.8 billion spending would be the highest for any year in our history—\$6.4 billion more than in the current fiscal year, and \$46.6 billion more than ten years ago. The deficit would be the 31st in the last 37 years.

In the cash budget, which includes social security, and more fully reflects the economic realities, total spending for fiscal 1967 is put at \$145 billion. This is \$10 billion more than in the current year and \$72.5 billion more than ten years ago.

Many dubious accounting gimmicks have been used to keep down the expenditure figures, to put up the revenue figures and to get a low deficit estimate. For example, the government proposes to sell private investors \$4.7 billion of Federal financial assets. But the expected proceeds from these sales, instead of counting as revenues, are counted as a reduction of expenditures. Scores of items scattered through every crevice of the new budget launch or continue programs that are sure to grow substantially later.

#### **HOW RELIABLE?**

The government counts on a huge \$11 billion increase in revenues. But only \$1.2 billion of this is to come from “temporarily rescinding” previous excise-tax cuts. About \$3.7 billion is to come from advancing corporate and individual income-tax payments. These are nonrecurring items. Again, the Treasury counts on \$1.6 billion “receipts” by a shift to silverless coins. The rest of the expected \$11 billion increase in revenues represents optimism about “economic growth.”

Suppose now, instead of accepting the spending and revenue figures on their face, we ask how reliable the estimates are. If we judge by the past, the answer is not reassuring. Last year Mr. Johnson estimated fiscal 1966 spending at \$99.7 billion; it is now placed at \$106.4—\$6.7 billion higher. A similar error for 1967 would mean administrative spending of \$119.5 billion and a deficit of \$8.5 billion, even if present accounting gimmicks were retained.

Suppose we go back to Mr. Johnson's predecessors. In January 1962 President Kennedy said: “I am submitting for fiscal 1963 a balanced Federal budget.” But there turned out to be a deficit of \$6.3 billion. In January 1961 President Kennedy submitted expenditures which he promised “will not of and by themselves unbalance



the earlier budget.” But the deficit for 1962 was \$6.4 billion. In fact, with few exceptions the budget estimates of the last 37 years have either grossly underestimated deficits or promised surpluses that never materialized.

### NON-DEFENSE BILLIONS

The truth is that we have never had a responsible budget—in the sense, say, that Great Britain has a responsible budget: one that, once adopted, both the legislature and the executive must scrupulously adhere to. What we have is a set of Presidential guesses not binding on anybody. But the budget just submitted by Mr. Johnson is irresponsible even in its proposals. At a time when he himself declares inflation to be our most serious economic danger, and when he is forced, according to his own estimate, to increase national defense expenditures in 1967 by \$10.3 billion because of Vietnam, it is irresponsible to propose also an increase in welfare programs by \$3.3 billion. If he had refrained from this increase he would have been able to report at least an intended surplus of \$1.5 billion instead of an intended deficit of \$1.8 billion.

The President talks as if only unavoidable defense costs create his budget problem. But if we compare even the 1967 budget with that of ten years ago (1956), we find defense costs up only \$20.5 billion while all other costs are up \$52 billion.

The new budget is undoubtedly inflationary. But it would be inexcusable to increase the already excessive and growth-stunting burden of taxation on the American people on the plea that this is necessary to combat the inflation. The way to prevent further inflation is to start slashing billions of fat out of 1967's projected non-defense spending of \$83.6 billion. ❁

## Big-Brother State

February 28, 1966

The annual *Economic Report of the President*, a child of the Employment Act of 1946, has come to be considered a sort of official economic textbook. Yet it is primarily a political rather than an economic document. I described it here in 1952 as “political propaganda paid for by the taxpayers.”

That description would apply to most of the annual economic reports, and certainly to the latest, which reads like a campaign speech. Most of it hammers in the message that you never had it so good and implies that you owe it all to the Great Society programs. The rest of it proposes still more controls and spending programs. All of these, of course, are to be piled on top of

all the welfare and subsidy programs that have grown up during the preceding 36 years. The idea that private competition, free enterprise and individual initiative ever accomplished anything is scarcely acknowledged.

These welfare programs are expensive, though in the President's Economic Report, otherwise crammed with euphoric figures, this expense is not mentioned. The government's total cash expenditures in fiscal 1967 will be \$145 billion, of which \$83.6 billion will be nondefense spending. Both figures will be the highest on record. Compared with only five years ago (fiscal 1961) non-defense spending will be up \$31.8 billion. Compared with ten years ago (fiscal 1956) it will be up \$52 billion.

### ALL TO SPONGE ON ALL

All this must be collected from the taxpayers. The government has nothing to give to anyone that it does not first take from the community. Yet Mr. Johnson constantly talks as if his Great Society programs will fill far more needs than the people could fill for themselves. Everybody is to live at the expense of everybody else.

This bewildering multiplicity of new programs adds up to the Big Brother state. Are there any unfulfilled desires anywhere? Then the government will fill them. If there are or ought to be any limits to the sphere and powers of the state, the Economic Report gives no hint of what they are.

The report makes scores of recommendations, but with one or two exceptions (e.g., more pollution control) nearly all of them are questionable. Instead of proposing that the government refrain from further inflation, the report seeks to end the balance-of-payments deficit by continuance of controls. It proposes that international monetary inflation be facilitated by “creation of new [non-gold] reserve assets.” It proposes that the aims of foreign aid be expanded. It proposes that the Federal government “rebuild” the cities—i.e., that the taxpayers of every city pay for the rebuilding of all the other cities—as if this somehow relieved them of the cost. It proposes to increase compulsory unionism even further by repealing Section 14(B) of the Taft-Hartley Act. It proposes to raise the minimum wage and so make it still harder for teen-agers and unskilled workers to get jobs.

### WHO MAKES INFLATION?

But what is of most immediate importance in the Economic Report is its discussion of inflation and the need of “maintaining cost-price stability.” At one point, it is gratifying to see, the report comes close to acknowledging that the primary responsibility for inflation lies with the government's own policies: “The basic precondition for price stability is a fiscal-monetary policy that deters total demand for goods and services from

outrunning potential supply.” But the report quickly takes this back by adding: “But the extent of the fiscal or monetary restraint that will be needed to avoid inflationary pressures will depend directly on the restraint and moderation exercised by those who have power over wages and prices.”

This is a clear reversal of cause and effect. If the government stops increasing the quantity of money, the average level of wages and prices cannot be raised. An excessive increase in the price of any given product will either reduce demand for that product or leave less purchasing power for other products. But if the government continues to print more money, and then tries to sit on individual prices, it will unbalance and disrupt production. Only governmental monetary policy, by commission or neglect, can create inflation. ❁

## An Election Proposal

March 14, 1966

To extend the terms of members of the House of Representatives from two years to four, but to make these terms coincident with the President’s, as Mr. Johnson has proposed, would have profound side effects on business. They would not be good.

Most of the arguments that the President has put forward for extending the term of congressmen to four years are sound. They would have more time to learn their job and to acquaint themselves with issues. They would have to devote less time and expense to getting themselves re-elected. But Mr. Johnson’s arguments for making every congressman’s election and four-year term coincident with the President’s are unconvincing.

Some senators and representatives had already suggested that four-year terms for House members be staggered so that half of them would be elected at the same time as the President and half in his midterm. This would certainly be moving in the right direction. But in his message of Jan. 20, Mr. Johnson sought to counter this proposal with the objection that it would “create an unnecessary and wholly unfair division” in the House. This is a very odd objection. The Senate from the beginning of its existence has been divided into thirds, with overlapping terms. In all his years in the Senate, Mr. Johnson did not complain of this division as either unnecessary or unfair.

### ONE-FOURTH EVERY YEAR

Mr. Johnson complains that: “‘Off-year’ elections are notorious for attracting far fewer voters—perhaps as much as 15 percent fewer—than Presidential elections.”

He does “not believe the Congress will wish to make the House the least representative of our three elective elements by perpetually condemning half its membership to a shrunken electorate.”

This is surely a strange argument. Today the *whole* membership of the House, and a third of the Senate, is “condemned” in off-year elections to a “shrunken electorate.” But no one has previously suggested that this weakens their political position. On the contrary, the congressmen elected in Presidential midterm are more likely to be elected on their own merits, and not merely on the President’s coattails or the party label.

The principle of staggered elections and overlapping terms, which already governs the Senate, should be carried still further. There would be clear advantages in electing one-fourth of the members of the House every year for four-year terms—and even in electing one-sixth of the members of the Senate every year, instead of the present one-third every two years, for six-year terms.

The primary advantage would be those “frequent elections” which the authors of the *Federalist Papers* thought the best assurance for securing that the House of Representatives should have “an immediate dependence on, and an intimate sympathy with the people.”

### IN CONSTANT TOUCH

Annual elections would keep both Congress and the President in constant touch with and response to public opinion. It would keep constantly alive the people’s interest in the policies of their government. It would give them a sense of constant control of these policies. In Britain intense interest is taken in a by-election, to fill a vacancy in Parliament, for whatever indication this may give of a new temper or verdict of the voters. Annually staggered elections to Congress would do this in a balanced and systematic way.

In the past, the months just prior to a national election have usually been marked by hesitation and uncertainty in business and the markets. The election of one-fourth of the members of the House each year would obviate the fear of a violent reversal of established policies, a complete overturn of the House, the election of a preponderance of new and inexperienced members. Above all, it would obviate the consequences of a momentary landslide, and a lopsided rubber-stamp Congress that had ridden in on the coattails of a charismatic Presidential candidate. Policies would not be fixed for four long years by the mood or fears dominant in a single election. Congress would be more likely to remain what the Founding Fathers intended a check and balance on Presidential power, and not merely one more instrument of that power. ❁

## Slash the Spending

March 28, 1966

For the last five years the “new economists” have denied that their policies led to more inflation. Now that they are at last forced to recognize this, they are proposing one of two cures, or both. The first is price and wage controls; the second is another tax increase. The first is not a cure at all but merely an additional disease. The second is harmful and unnecessary.

The simple cure for inflation is to stop inflating. The direct cause of inflation is the increase in the quantity of money and bank credit; the direct cure is to stop this increase. In order to make this possible we must stop the budget deficits. There are two ways to do this. One is to increase taxes; the other to cut expenditures.

But a further tax increase, on top of the \$5 billion annual increase in social-security taxes that went into effect Jan. 1, and on top of the \$6 billion increase just enacted, i.e., on top of the unparalleled tax burden of \$145 billion that the American people already carry for 1967, would discourage production and constrict the economy. No one has been more insistent on this result in the last few years than the new economists themselves. They supported a tax reduction when we could not afford it. As we already had an inflationary deficit, the tax cut simply made it greater. It was therefore a sham tax cut. It merely substituted inflation, which President Johnson has called “the most unjust and capricious form of taxation,” for other taxes.

### HUGE NON-DEFENSE COST

And it was the wrong kind of tax cut, both politically and economically. If everyone’s taxes had simply been cut by an equal percentage, it would now be politically easy to restore them by a corresponding percentage. But proportionately the tax cuts were greatest on the low-bracket incomes, making income-tax rates even more steeply progressive than they already were. The Administration and Congress would therefore not dare now to restore personal income tax rates to their previous levels because they would be accused of making the increase greatest on the lower incomes.

Yet with the clear threat of further inflation, it is imperative that we reduce or eliminate the “inflationary gap,” i.e., the excess of expenditures over revenues. The best way to do that is to reduce expenditures.

We are being told that this cannot be done, because the present huge spending is necessary to pay for the war in Vietnam. But this is not so. In the cash budget for the fiscal year 1967 total national defense expenditures are estimated at \$60.5 billion. *Non-defense* spending comes to \$83.6 billion. If we compare the 1967

budget with 1956, we find that defense costs in this eleven-year period have risen only \$20.5 billion while non-defense spending has increased by \$52 billion. The way to prevent further inflation is to start slashing this enormous non-defense total.

### SAVING \$10 BILLION

How many billions need to be slashed off? Technically, the 1967 cash budget is already estimated to be in balance. But if (allowing for the dubious accounting gimmicks and the probable underestimate of expenditures) we assume that the real deficit will be at least \$5 billion to \$10 billion, then this is the amount that expenditures should be cut.

Anyone who thinks there is anything unreasonable or impossible about a cut of these dimensions need merely look at the increase in non-defense spending in the last few years. For 1967 it is \$12 billion more than in 1965, \$23 billion more than in 1963 and \$32 billion more than in 1961. All we have to do to cut out even \$10 billion is to cut out the new spending programs added since 1965 alone. If we don’t want to do it that way, we might do it by slashing one or two of the more dubious categories of spending such as the \$4 billion for foreign aid, the \$3 billion for farm subsidies, the \$4 billion for the most expensive road-building program in history, the \$4 billion for putting a man on the moon or part of the \$46 billion of welfare spending.

But don’t let anyone tell you that we need to levy \$5 billion or so of increased taxes (on top of \$145 billion already there) to “prevent inflation” or to pay for the Vietnam War. The money is “needed” only to pay for the extravagant Great Society programs of the last few years. ❁

## Minimum Wage vs. Jobs

April 11, 1966

If there is anything that economists of nearly all schools are agreed upon, it is the folly of minimum-wage laws. They hurt most the very people they are designed to “protect.” When a law exists that no one is to be paid less than \$50 for a 40-hour week, then no one whose services are not worth \$50 a week to an employer will be employed at all. We cannot make a man worth a given amount by making it illegal for anyone to offer him less. We merely deprive him of the right to earn the amount that his abilities and opportunities would permit him to earn, while we deprive the community even of the moderate services he is capable of rendering. In brief, for a low wage we substitute unemployment.



Among eminent economists who have recently expressed their opposition to minimum-wage laws are Prof. James Tobin, formerly President Kennedy's economic adviser; Prof. Arthur Burns, former head of the President's Council of Economic Advisers, and Prof. Gottfried Haberler of Harvard. As Professor Tobin has put it:

"People who lack the capacity to earn a decent living need to be helped, but they will not be helped by minimum-wage laws, trade-union wage pressures or other devices which seek to compel employers to pay them more than their work is worth. The more likely outcome of such regulations is that the intended beneficiaries are not employed at all."

### CONTINUAL BOOSTS

The Fair Labor Standards Act of 1938 fixed a minimum wage of 25 cents an hour. This was raised to 30 cents in 1939, to 40 cents in 1945, to 75 cents in January 1950, to \$1 in March 1956, to \$1.15 in September 1961 and to \$1.25 in September 1963.

In an illuminating study published in *The Management of Prosperity* (Columbia University Press, \$3.50), Professor Burns has found that each time the minimum was raised, it was set at approximately half of the average manufacturing wage. However, the statutory minimum was only 29 percent of average hourly earnings in manufacturing just before the increase in 1950, while the corresponding figure reached 40 percent just before the increase of the minimum in 1956, 43 percent before the increase in 1961 and 47 percent before the increase in 1963.

Thus, over the years there has been a strong rise in the ratio of the legal minimum to the average wage. The minimum wage rose 67 percent between early 1956 and 1964, while average hourly earnings in manufacturing rose 34 percent. Meanwhile, the Federal minimum has become effective over a greater range of industry, and many states have likewise raised or expanded the coverage of their minimum wages.

### UNSKILLED MOST HURT

The result of all this has been to force up the wages of unskilled labor much more than those of skilled labor. A result of this, in turn, has been that though an increasing shortage has developed in skilled labor, the proportion of unemployed among the unskilled, among teen-agers, females and non-whites has been growing. The ratio of the unemployment rate of teen-agers to that of male adults, Professor Burns finds, was invariably higher during the six months following an increase of the minimum wage than it was in the preceding year.

"The broad result of the substantial increase of the minimum wage in recent years," Professor Burns

concludes, "has therefore been a curtailment of job opportunities for the less skilled workers." And his calculations indicate that "another increase of 25 cents in the minimum wage would be likely to raise the unemployment rate of non-white teen-agers by as much as 8 percentage points." Teen-ager employment has improved recently at least in part because the minimum wage has not been raised since September 1963.

Professor Haberler concludes that "Raising the minimum wage would thus be an irresponsible anti-social measure, reducing job opportunities of the poor, promoting inflation and retarding growth."

Yet under pressure from the union leaders, Congress is all set to give another boost to the compulsory minimum wage from its present level of \$1.25 an hour to \$1.40 next February and \$1.60 in February 1968 and to extend the coverage to more than 6 million more workers. ❁

## Why Inflation Grows

April 25, 1966

While expressing constant concern about inflation, the Johnson Administration is still inflating. It is scolding the symptoms while doing nothing to stop the causes.

The cause of inflation is the increase in the quantity of money and credit. The money supply (including time deposits) now stands at a new high record of \$317 billion, 9 percent higher than a year ago, and 48 percent higher than at the end of 1960.

One main reason for the increase in the money supply is the action of the Federal Reserve System in buying and "monetizing" U.S. Government securities. It holds today \$41.1 billion of them, which is \$3.3 billion more than a year ago. Interest rates are still kept low enough to encourage continued expansion of bank credit.

The rapid increase in the money supply has been in turn brought about by the Federal deficits. We are heading into the 31st deficit in the last 37 years. The real cash deficit for 1967 is concealed by various book-keeping gimmicks and an underestimate of probable expenditures. Objective analysts expect the real deficit to be \$5 billion to \$10 billion.

### TAX CUT OR SPENDING?

The deficit can be reduced or wiped out either by reducing expenditures or by raising taxes. By all odds the sounder course is to start restraining nondefense expenditures, and certainly not to impose any further tax increase. Cutting planned expenditures by \$5 billion or \$10 billion might be awkward for vote-conscious



politicians but could be done with economic advantage all around. Planned nondefense expenditures for 1967 are \$12 billion more than in 1965, \$23 billion more than in 1963 and \$32 billion more than in 1961.

Those who argue that the only way to eliminate the deficit is to raise taxes are by implication making the preposterous claim that every dollar of the \$83.6 billion of nondefense expenditures planned for the next fiscal year is essential and untouchable. Yet this nondefense total alone is \$52 billion higher than ten years ago.

The Republicans in Congress are on the right track in pushing for a cut in spending. Their voting record in this respect is far from perfect, but it is immensely better than that of the Democratic majority. In seeking to cut a uniform 5 percent out of each domestic appropriation bill the Republicans, it is true, are not adopting the most defensible course. A family forced to cut expenses would hardly think it sensible to cut both its food budget and its annual vacation in Europe by the same percentage.

The Republicans in Congress would be in a stronger position if they (and, we may hope, Democrats too) were to memorialize the President to submit an amended budget cutting at least \$5 billion out of his present proposed total cash spending of \$145 billion for 1967. This ought not to be too difficult. The nondefense part of this spending alone is \$6 billion more than in the current fiscal year and \$12 billion more than in 1965. If the President refused to make his own cuts, he would be in a poor position to criticize the cuts made by Congress.

There are decisive reasons why a further tax increase at this time would not be justified:

1—Such an increase is not necessary if present unparalleled nondefense spending is cut.

2—All tax increases retard and restrict economic growth.

3—They would not bring in revenues that would be proportionate to increased rates.

4—The tax reductions made in the last two years, in the face of existing deficits, were political. The Treasury's own estimates showed that 78 percent of the reduction in personal income taxes enacted in 1964 was made in the taxable income brackets of \$4,000 and under. Congress would not dare to restore the 1963 rates for fear of being accused of throwing the burden on the low incomes. But the necessary revenue simply could not be raised by restoring the rates only in the brackets above \$10,000.

5—Finally, an increase in taxes of \$5 billion would be completely futile if the President and Congress

continued to increase spending with the casualness and recklessness of the last few years. We would face the grim prospect of a thumping tax increase *plus* still more inflation.

There is no substitute for a curb on spending. ❁

## Retarding Growth

May 9, 1966

The Johnson Administration now daily proclaims its concern about inflation, while it completely ignores its own chief role in creating it and puts the blame on everybody else, particularly businessmen. It neglects the right remedies and presses for the wrong ones. But of all the strange things it is doing, perhaps the strangest is to urge businessmen to reduce their investment in new plant and equipment.

The fear that productive capacity is expanding too fast, or that costs of production are being reduced too much, reveals a complete confusion of cause and effect. The present high rate of plant expansion and capital-goods expenditures is not a cause of inflation; it is simply one of the results of inflation. The direct cause of inflation is the increase in the quantity of money and credit. The newly created money must go somewhere. If the Administration can succeed in keeping it from going into productive investment, it will merely go into unproductive consumption.

### WHY PLANT EXPANSION

The reason a good deal of the new money is going into plant expansion is clear. The new money increases monetary demand in varying degrees for nearly all products. It tends to raise their prices. Corporations, making bigger sales and bigger profits, are encouraged to invest in additional and newer plant and equipment to expand their output and increase their margins of profit. If they expect inflation to continue, their stimulus to plant expansion is even greater. The sooner they expand, the cheaper they can get their new plant and equipment; the longer they delay, the more it will cost them—not to speak of the profit they will lose if expansion of output is delayed.

Of course this has its dangers. Inflation and the expectation of more inflation create distortions, illusions and false expectations. Much of the new investment will go into the wrong places. It will not pay off. But the cure is for the government to halt its inflation before it is too late; it is not to call up businessmen and to ask them to exercise "voluntary restraint" in new

investment. This vague admonition may merely reduce or prevent precisely the new investment that most needs to be made, without preventing gross malinvestment by those less vulnerable to political pressure.

The quantity of money and credit (including time deposits) has been increased by 9 percent in the last year and 48 percent since the end of 1960. The way to reduce or halt this rate of increase is for the Federal Reserve System to stop buying and monetizing government securities (it has made encouraging moves in this direction in recent weeks), and for the government to stop all attempts to hold down interest rates.

### INTEREST RATES HIGH?

Historically the present 5½ percent prime lending rate of the banks seems high. But if we assume the continuance of the 2.8 percent annual rate of increase in consumers' prices, this 5½ percent reduces to a real interest rate, allowing for dollar depreciation, of only about 2.7 percent. This is why business borrowing demand continues to be heavy.

There is an obvious inconsistency between the Administration's call for investment cutbacks and its decision to retain the 7 percent investment tax credit. But let us hope this inconsistency is resolved in favor of keeping the investment credit. It would be a serious mistake to suspend it. It was enacted by Congress, on President Kennedy's recommendation, to stimulate capital investment, promote economic growth and make American industry more efficient and more competitive abroad. It is a necessary offset to an excessive corporate income tax. It tends to increase productivity, to provide better-paying jobs, to reduce costs and hence to reduce prices to consumers.

It was designed to be permanent. To try to turn it into an off-again, on-again countercyclical device would lead to belated and unpredictable responses and create business uncertainty. It would substitute the unreliable judgment and timing of government bureaucrats for that of businessmen close to their own special markets.

Let the government stop its inflation, and leave the investment decisions to private enterprise. ❁

## The Attack on Profits

May 23, 1966

It was bound to happen. Any observer of any previous inflation anywhere could have safely predicted it. The government, having deliberately adopted inflation as a policy, is now blaming businessmen for the unpopular

part of its consequences. The attack is led by the very man who has been the chief advocate of the government's present inflationary policies—Gardner Ackley, chairman of the President's Council of Economic Advisers. He has been the official spokesman for the "new economics," for big spending, chronic deficits, cheap money and every other policy that leads to an expansion of the money and credit supply and a lower value of the currency unit. It is he who now exclaims that profits are much too high. "And so I ask you," he warns businessmen, "to stop, look and listen. Is that price increase you are considering really necessary?" His speech before the United States Chamber of Commerce was ominously reminiscent. The particular rationale for inflationary policies that Ackley has adopted was first advocated by John Maynard Keynes in 1935. Because the chief problem of that time was depression and unemployment, Keynes entirely forgot his own eloquent warning in his "Economic Consequences of the Peace" in 1919:

### KEYNES'S WARNING

"Lenin is said to have declared that the best way to destroy the Capitalist System was to debauch the currency. . . . Lenin was certainly right. . . . The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose. . . ." The governments of Europe, being many of them at this moment reckless in their methods as well as weak, seek to direct onto a class known as 'profiteers' the popular indignation against the more obvious consequences of their vicious methods. These 'profiteers' are, broadly speaking, the entrepreneur class of capitalists, that is to say, the active and constructive element in the whole capitalist society, who in a period of rapidly rising prices cannot help but get rich quick whether they wish it or desire it or not. If prices are continually rising, every trader who has purchased for stock or owns property and plant inevitably makes profits. By directing hatred against this class, therefore, the European Governments are carrying a step further the fatal process which the subtle mind of Lenin has consciously conceived. The profiteers are a consequence and not a cause of rising prices. . . ."

### ROLE IN PRODUCTION

Even Keynes failed to recognize all the distortions brought about by inflation. For a great part of the profits reported by corporations in an inflation are illusory. The deductions for depreciation and replacement, for example, are increasingly inadequate. Moreover, profits

are a *residual* amount, and therefore their fluctuations in either direction are always more violent than those, say, of wages. In 1932 and 1933, profits were actually a negative sum. Ackley's implication that present profits are excessive because businessmen are overcharging, and that they could easily make a substantial voluntary cut in prices, is refuted by the government's own comparisons of profits after taxes per dollar of sales. In 1965 these averaged 5.6 cents. An average cut of only 1 or 2 percent in prices would have brought profits per dollar of sales below the 4.5 percent average level of the five years 1959–63. Moreover, profit margins are different for each firm. A price cut that one firm could easily "afford" might force another in the same industry to close down. The cure for high profits is high profits. High profits stimulate production, attract competition, increase supply and thereby tend to lower prices. Profits, wages and employment go up and down together. When profits are highest employment is highest. Any direct government attempt to squeeze profits is bound to hurt wages and employment. Last year corporate profits after taxes were only 8 percent of the national income. Yet profits play a vital and indispensable role in causing, guiding, allocating and increasing production. There is only one way for the government to stop the distortions and unpopular effects of inflation, and that is to stop inflating. ❁

## The Cost of Guideposts

June 6, 1966

It would be immensely reassuring if the Administration not only abandoned all efforts at "voluntary" price control and all threats of compulsory price control, but quietly dropped all the nonsense about "guideposts" that the Council of Economic Advisers has been preaching for four years. No one has yet spelled out all the harm that these guideposts have done and are still doing. They are imposed without legal authority and by veiled threats of public censure, antitrust prosecution, income-tax investigation, cancellation of defense contracts or other penalties. The guideposts are discriminatory as between unions and businessmen. Union workers are supposedly "entitled" to a 3.2 percent annual advance in wage rates, based on some calculation of "average growth of labor productivity," but business is not entitled to any price advance at all. The guideposts are discriminatory as between industries, because public obloquy can be more effective in a line of production, such as steel, aluminum or automobiles, dominated by

a few big nationally known corporations, which make easy targets, than in a line of production in which there are thousands of small firms, no one of which can be easily turned into a political scapegoat.

The guideposts are discriminatory as between unions, because when a powerful union contemptuously ignores them, the Administration is either silent or makes a barely audible murmur after the damage has been done. We have yet to see a President demand a rollback of wages.

### FUNCTION OF PRICES

Nearly all criticism of the guideposts has concentrated on such discrimination. Unfortunately, much of it has implied that there can really be such a thing as "fair" wage and price controls. The truth is that though the standards adopted by the CEA for fixing guideposts are completely untenable, there are no tenable standards. These guideposts are all based on crude notions of "fair" wages, "fair" prices and "fair" profits; but what is essential is *functional* wages, prices and profits.

All price-fixing does harm. Even if the government were not continually cheapening the dollar by continually increasing the money supply, it would do immense harm to try to "hold the line" by freezing every price just where it is. Prices have work to do. They guide and allocate production. A price rise for product X usually reflects an increased demand for X or an increased cost of producing X; a price fall for product Y usually indicates a reduced demand for Y or a reduced cost of producing Y. It is precisely the daily *relative* changes in prices and profit margins that direct more production into the products that are more wanted and release labor and capital resources from products that are less wanted. To freeze relative prices is to reduce, distort and unbalance production.

### REMEDY POSTPONED

All this would be true even if the government were not constantly increasing the quantity of money. But when it cheapens the dollar and *then* tries to "hold the line" on prices, the harm is immensely multiplied.

An incisive analysis of the cause of inflation and the harmfulness of the guideposts was made in a recent speech by Milton Friedman, economist at the University of Chicago:

"Inflation is always and everywhere a monetary phenomenon, resulting from . . . a rise in the quantity of money relative to output. . . . The guideposts confuse the issue and make correct policy less likely. If there is inflation or inflationary pressure, the governmental monetary authorities are responsible. It is they who



must take corrective measures if the inflation is to be stopped. Naturally, the authorities want to shift the blame, so they castigate the rapacious businessman and the selfish labor leader. By approving guidelines, the businessman and the labor leader implicitly whitewash government for its role and plead guilty to the charge. They thereby encourage government to postpone taking the corrective measures that alone can succeed. . . .

“Whatever measure of actual compliance there is introduces just that much distortion into the allocation of resources and the distribution of output. . . . The more faithfully [the guideposts] are complied with, the more harm they do.” ❁

## Income-Tax Illusions

June 20, 1966

An increasing number of economists (though still a minority) are beginning to have second thoughts about the wisdom of the progressive income tax. Their misgivings arise from three main suspicions: (1) that it is unjust; (2) that it undermines incentives and sets back economic growth; and (3) that the high rates at the upper end of the scale do not even produce increased government revenues, but tend to reduce them.

The argument that a discriminatory “progressive” tax rate is unjust was stated as long ago as 1833 by the Scottish economist J.R. McCulloch:

“The moment you abandon the cardinal principle of exacting from all individuals the *same proportion of their income or of their property*, you are at sea without rudder or compass, and there is no amount of injustice and folly you may not commit.”

The principle that the same *rate* of tax should apply to everybody was almost universally established before the “graduated” income tax came along. This principle is still adhered to in every other type of tax—real-estate taxes, sales and other excise taxes, import duties and even social-security taxes. It is accepted that a man whose house and land are worth ten times as much as another’s should pay ten times the tax but not (as can happen under progressive rates) 30 times the tax.

### NO ASSIGNABLE LIMIT

Some economists are beginning to recognize that all arguments in support of progression can be used to justify any degree of progression. No one dreamed, when the income tax was adopted in Great Britain in 1910 and in the United States in 1913, that within a generation Britain would be taxing the higher incomes up to 97½ percent, and the U.S. up to 91 percent. When

a majority imposes on a minority a punitive rate of taxation that it refuses to accept for itself, democracy becomes irresponsible.

The higher rates in the progressive income tax undermine incentives and reduce production and capital accumulation. The early sponsors of the progressive income tax recognized this, but they had other aims in mind. In the *Communist Manifesto* of 1848, Marx and Engels frankly proposed “a heavy progressive or graduated income tax” as an instrument by which “the proletariat will use its political supremacy to wrest, by degrees, all capital from the bourgeois, to centralize all instruments of production in the hands of the state” and to make “despotic inroads on the right of property, and on the condition of bourgeois production.”

### RATES VS. REVENUE

Progressive rates of income taxation are not necessary to raise great revenues. A simple calculation, based on the Treasury’s own figures, shows that, with the same existing exemptions and deductions, a flat rate of 18.6 percent would raise all the revenue now raised from the scale of rates ranging from 14 to 70 percent. If all rates now above 50 percent were reduced to that level, then (on the basis of 1963 incomes) a maximum of \$233 million revenue would be lost. This is not enough to run the government, at present spending rates, for a full day. For 1963, more than two-thirds of the total income tax was paid by people with adjusted gross incomes under \$15,000.

Yet perhaps the most serious evil of the progressive income tax is that it produces the *illusion* in the overwhelming majority of taxpayers that the “rich,” the other fellows in the brackets above them, are really paying for most of the benefits that the majority get from the government. This illusion is shared even by taxpayers (all those with taxable incomes above \$6,000) who are in fact paying more than the 18.6 percent average rate that would yield the necessary revenue. This illusion makes them accept a burden of government expenditure and taxation that they would not otherwise tolerate. Though this aspect of progressive income taxation is very little discussed today, its menace was recognized as early as 1899 by W.E.H. Lecky:

“Highly graduated taxation realizes most completely the supreme danger of democracy, creating a state of things in which one class imposes on another burdens which it is not asked to share, and impels the State into vast schemes of extravagance, under the belief that the whole costs will be thrown upon others.” ❁



## Shortsighted Remedy

July 4, 1966

The latest and in some ways the most thorough study that has ever been made of "The United States Balance of Payments" has just been published in a large book of 200 pages by the International Economic Policy Association. This is a private research group whose membership includes twenty major U.S. corporations. It makes, altogether, 33 recommendations for solving the payments deficit. Most of these are in the right direction, and some of them are excellent.

The most important recommendation is negative: the Administration should abandon as soon as possible its restraints on foreign investment.

By trying to restrain and penalize foreign investment, the government is in effect treating such investment (which even in total accounts for less than 10 percent of our outgoing payments) as if it were actually the cause of the payments deficit. Making foreign investment the scapegoat is completely arbitrary. It happens also to be foolishly shortsighted.

### WHOSE DEFICIT?

The IEPA study, in fact, points out that for several years the private sector as a whole, as a result of export surpluses and income on private investments abroad, has generated a payments surplus, while Federal spending (foreign aid, military outlays, etc.) has been "consistently in deficit by over \$3 billion a year, notwithstanding tied aid and military-hardware sales." The study calculates that exports to affiliates of U.S. manufacturing corporations account for 35 percent of total U.S. exports of manufactured goods. In addition, direct investments abroad by U.S. companies return earned income which exceeds the outflow of capital in nearly every industry and in practically every area of the world.

The government insists that its foreign aid, even though it is given away, does not seriously add to the payments deficit. This is because, it argues, 80 percent of AID's economic assistance has been in the form of goods and services procured in the United States. The IEPA study admits that this device of "tying" aid to purchases in the U.S. may curtail the *direct* adverse impact on the payments balance. But it points out that the government's calculation fails to allow for the "substitution" effect. The aid-receiving country, in other words, may use its aid dollars merely to buy goods it would otherwise have bought here commercially with dollars it already owned. It is then able to transfer its earned dollars for purchases in other countries.

### SUBSTITUTION EFFECT

Strong evidence that this is happening on a large scale is provided by a comparison of our aid to and trade with Latin America. U.S. net disbursements to Latin America almost doubled from the level of the 1956–1960 period, when they averaged roughly \$360 million, to an average of about \$652 million over the 1961–1964 period. Total Latin American imports went up from an average of \$7,650,000,000 a year between 1956 and 1960 to an annual average of \$8,060,000,000 during 1961–1964, an average increase of \$413 million. Yet total Latin American imports from the U.S. *declined* by an average of \$100 million, despite the doubling of total aid and the "tying" of such aid.

There is reason to think that the "substitution" principle has an even wider application than the IEPA study estimates, but there is not space to consider its ramifications here. If the study has a serious weakness, it is in not giving sufficient emphasis to the effect of inflation and our chronic budget deficits in making the deficit in the balance of payments inevitable.

But the great merit of the study is its proof of the harmfulness of governmental restraints on foreign investment. A substantial part of our exports depends upon such investment. The study urges the government to give assurances that, in addition to maintaining the gold value of the dollar, it will not try to restrict or control the movement of capital. "The only really long-run factor working in the direction of eliminating deficits," the study insists, "is the growth in exports, income, royalties and fees which are related to direct private investments abroad. Any prolonged limitations in this area can serve only to weaken whatever long-range strength there is in the U.S. position." ❁

## Socialism, U.S. Style

July 18, 1966

New York City's first subway opened in 1904. The fare was 5 cents. The subways remained under private ownership until 1940. The fare was still 5 cents. But meanwhile wholesale prices had gone up 32 percent; wage rates had tripled; the lines were granted tax exemption by the city. They petitioned for higher fares. But the 5-cent fare was sacred. The city fathers decided that the only way to keep it was to eliminate private profit and run the trains themselves.

So the subways were bought by the city in June 1940. On July 1, 1948, the fare was doubled to 10 cents. On July 25, 1953, it was tripled to 15 cents. Between 1940 and 1953 other consumer prices went up 91 percent, but

New York subway fares went up 200 percent. The lines were still run at heavy loss. Even by its own method of accounting, the Transit Authority has lost money in seven out of the last ten fiscal years. If even one of its several subsidies from the city is deducted, it has lost money heavily in every one of those years.

The Transit Authority, which runs the subways for the city, is required by law to operate within revenues received from operations. This is a rather technical requirement. In the first place, capital funds (such as for subway construction, subway cars and buses) are provided by the City of New York. There is a subsidy for carrying schoolchildren, and a subsidy for Transit Police.

### **\$62 MILLION LOSS**

In the fiscal year ended on June 30 last, the Transit Authority reported an operating deficit of \$62 million. This deficit was achieved in spite of a tax subsidy of \$166 million to Transit for the fiscal year. The subsidy was made up of New York City's outlays for all debt service, construction and new equipment of \$116 million; the subsidy for student fares of \$20 million, and the subsidy for Transit Police of \$30 million.

And now the fare has been raised to 20 cents—a 300 percent increase since 1940. The extra 5 cents is expected to bring in something in excess of \$60 million, but probably will not be enough to cover the operating deficit even when all the subsidies are included. A 25-cent fare may be less than a year away.

As the charge for the service has been going up, the quality has been going down. The trains run less frequently; they don't meet schedules; they get older and dirtier, and so do the stations.

The *Wall Street Journal* recently complained in an editorial: "The change-makers in the municipally operated subway system refuse, usually with great rudeness, to accept a \$5 bill or anything higher. . . . A person finding himself with nothing under \$5 has no choice but to trudge back up the stairs and find a store willing to make change. Nine times out of ten the shopkeeper will do so in perfectly friendly fashion. The contrast is illuminating. The salesman in the store knows his livelihood depends on courtesy and service. To many a minion of bureaucracy, however, people are nuisances at best and to be treated as such."

This is "public" ownership. This is how socialism, U.S. style, works.

### **SUBSIDIZING FARES**

A theory has developed that municipal transportation ought not even be expected to pay its way. This theory is merely the outgrowth of government ownership. When

cities own and operate the subways, the fare must be subsidized. When governments own the railways, the railway fare must be subsidized. When governments own the telephone and telegraph lines, the lines are subsidized. When governments own the power and the light companies, power and light are subsidized. When governments own the airlines, the airlines are subsidized. Governments run the mail service, and the mail is carried at a loss. Nothing is expected to pay its own way.

A subsidy on bread would be more defensible than any of these, but the government doesn't yet own and run the bakeries.

The socialist argument begins by saying that fares are too high because private industry is under the necessity to make a profit. What is overlooked is that it is precisely the need to make a profit, or to avoid a loss, that leads to economy, efficiency and good service. Government ownership removes the incentive to all three. ❁

## **Prices Have Work to Do**

August 1, 1966

The Administration forced the leading producer of molybdenum, a metal used in steel alloys, to cancel a 5 percent price increase announced a few days before. Why? To show the labor unions that the Administration isn't afraid of them.

Believe it or not, this is the reason government officials gave when they disclosed to reporters their "basic motive for applying pressure on the company for the rollback." As one prominent news account put it: "They wanted to demonstrate to unions, as much as to management, that the Administration's anti-inflationary wage-price guidelines are not a dead letter."

One would think the obvious way to demonstrate this would be to forbid wage increases beyond the guidelines or to force some union "voluntarily" to roll back a wage increase. Of course the Administration (fortunately) has not the slightest intention of doing this.

Let us look at the harm, however, that it is actually doing. The forced cancellation of the molybdenum price increase was arbitrary, discriminatory and without any sanction of law. In recent months the Administration has allowed price increases to occur in scores of items—services, apparel, shoes, tires, coal—without comment. It continues to force its rollbacks in industries—steel, aluminum, molybdenum—in which the bulk of the product is produced by a few big companies politically vulnerable to intimidation.

### BLAMING MOLYBDENUM

When it forced the rollback in steel, the Administration's excuse was that steel entered into so many products that a rise in steel prices would touch off another round of inflation. This excuse was lame enough as applied to steel (the total market value of which is only 2.6 percent of the gross national product), but it is completely absurd for officials to be speaking of the "direct inflationary impact" of a rise in molybdenum, the market value of which is less than one-fiftieth of 1 percent of the gross national product. To pounce on molybdenum as a scapegoat, out of thousands of products, is legally indefensible and economically ridiculous.

It is also economically harmful.

Prices have work to do. They guide consumers and producers. Molybdenum is in short supply. The rise in price would have led to more economy in consumption. And the rise was needed, according to the industry, to finance new facilities to produce the metal. It is not "in the national interest" to reduce incentives and funds for increased production.

### NEEDED SIGNALS

It was absurd for Gardner Ackley to demand a cancellation of the price increase on the ground that the leading producer, American Metal Climax, was making profits above the average. This represents a complete failure to understand the working of a free-enterprise system. It is precisely constant *relative* price changes, and the consequent *differences* in profit margins in different commodities, that draw labor and capital resources away from the production of goods in relative oversupply and into increased production of goods in short supply. To freeze the price mechanism is to destroy the price signals and to prevent these necessary readjustments in production. It is the constant changes in price relations and in relative profit margins that determine the ever-changing balance in the relative production of thousands of different commodities and services.

It is the Administration, not private business, that is inflating. The cause of inflation is the increase in the quantity of money and credit. The Administration keeps increasing the quantity of money and credit. The nation's money supply (demand deposits plus currency) averaged \$171.6 billion in June, up 5.8 percent over the twelve-month period. By comparison, money rose at a 2.2 percent average annual rate from 1951 to 1965. If we include time deposits in the money supply, the rate of increase over the past year has been 9.3 percent. Higher interest rates discourage credit expansion and inflation; lower interest rates encourage credit expansion and inflation. The Administration is doing all it

can to keep interest rates below the level at which a free market would set them. It inflates, and points an accusing finger at molybdenum. ☸

## How We Create Strikes

August 15, 1966

The crisis on the airlines is merely the latest example of the bankruptcy of most of the labor legislation of the last 40 years.

The naïve theory of the Wagner Act of 1935, ironically called "an act to diminish the causes of labor disputes," was that it was above all "the denial by employers of the right of employees to organize and the refusal by employers to accept the procedures of collective bargaining [that] lead to strikes." The simple cure was to abolish this gross "inequality of bargaining power" by turning the government into a union-organizing agency and *compelling* employers to bargain exclusively with certified unions. One-sided compulsions were laid on employers. One-sided immunities were granted to unions. And of course: "Nothing in this act shall be construed so as to interfere with or impede or diminish in any way the right to strike."

So it has been. The number of annual strikes tripled after the Wagner Act went into effect. In 1947 the consequences became so bad that Congress passed the Taft-Hartley amendments. These made the Wagner Act slightly less disruptive but retained its essential one-sidedness.

### THE PUBLIC HELPLESS

The result today is that a single labor union, until its demands are met, can halt the country's railroads, tie up its shipping, shut down its steel mills, silence the newspapers of a great city, walk out on patients suffering or dying in hospitals, ground 60 percent of the nation's airlines, and prevent others from taking the jobs that its own members have refused to perform. The public must stand by helpless.

The machinists' strike on the airlines illustrates this enormous irresponsible power. To avert a strike, President Johnson appointed an emergency board under the Railway Labor Act. That board recommended a 3.5 percent annual increase over 42 months in the average \$4.15 an hour in wages and benefits already received. This award was in excess of the government's own 3.2 percent "non-inflationary guidelines." The companies accepted the award; the unions rejected it.

The President originally used his full prestige to urge acceptance of the award, based on "testimony



that runs into the hundreds of pages.” When the union said no and continued the strike, Mr. Johnson made it clear to the airlines (which all need Federal approval for routes, rates and airmail subsidies) that he wanted them to give more. They then offered increases of 4.3 to 4.5 percent a year, which the union negotiators accepted. The President was still somehow able to assure the country that the agreement was “essentially within the general framework” of the emergency board recommendations (it was 25 percent higher), and even that it “will not be inflationary.”

Then the union rank and file turned thumbs down even on this.

### TIME TO REEXAMINE

Whatever happens now, irreparable harm has already been done. The airline machinists were offered rewards, not penalties, for spurning the recommendations of a government board, and frustrating or stranding travelers. Other unions will note these rewards, demand at least as much, be at least as intransigent.

Compulsory back-to-work laws and longer “cooling-off” periods only postpone the reckoning as long as unions are given a legal stranglehold over industries. In the last generation we have removed the chief risks from striking and made it next to impossible for an employer to combat a strike.

When an employer is confronted with a strike today he hardly dares to try to carry on his business. First, union monopolies are so tight that it is difficult to find other sources of labor. Secondly, if he tries to hire replacements, he meets violence and vandalism on the picket line, and the Norris-LaGuardia Act in effect denies him injunctive relief. Thirdly, if these obstacles are overcome, the National Labor Relations Board, even years later, may order him to rehire all the original strikers with back pay.

Until Congress is willing to reexamine and drastically revise its labor legislation of the past, we will continue to have strike chaos or be forced into the evils of compulsory arbitration. ❁

## Forced Arbitration?

August 29, 1966

When the striking machinists’ union, before exacting its guideline-smashing 6 percent settlement, turned down not only the 3.5 percent wage-increase award offered by the President’s emergency board but even the 4.3 to 4.5 percent increase then offered by the airlines under White House pressure, even newspapers

that prided themselves on their “liberal” opinions began to demand compulsory arbitration.

When a major strike is causing great public hardship, such a demand seems plausible. The strike is obviously harming not only the workers and industries involved but other workers and industries. The damage done may be nationwide and grave. Should not the government have a right to prevent it? Every strike will eventually be settled on some terms. Why not have an impartial tribunal fix such terms, and save the costs, waste and disruption of a prolonged and bitter strike?

What is usually overlooked by the advocates of compulsory arbitration is that we already have something very close to it, and it has obviously failed. The airlines strike was handled under the Railway Labor Act, which we have had since 1926. Under that act, when a strike has been called, the President has the power to require the workers to stay on the job for 30 days while he names an emergency board to study the dispute and report its recommendations within that time. President Johnson had already done this. When the machinists rejected the Presidential board’s recommendations and walked out, it was not the first time transportation workers had done so. They have done it repeatedly. In practice the board’s final recommendations have been binding in effect on the employers while unions have rejected them.

### IT KILLS BARGAINING

Once it is known, or even suspected, that a governmental board will eventually recommend settlement terms, serious collective bargaining usually stops. Each side makes only enough concessions to give the appearance of bargaining. Both sides reserve their real arguments for the arbitrators.

Compulsory arbitration could only increase the number of threatened strikes. The tendency of all arbitrators is not to find what settlement terms would be “just,” but to find some acceptable middle ground between the employer’s last offer and the union’s demand.

After the first major compulsory award had been made, the government arbitration boards would face the demands of all other unions who felt they had had a less favorable deal. The arbitrators will be under tremendous pressure to make all their awards “consistent.” But what will “consistency” consist in? In granting all other unions the same *percentage* wage increase? Or the same *dollar and cents* wage increase? And from what common past base would the increase be measured? Or would the boards fix the same “just” wage rate for everybody, regardless of skill or past differentials? In



any case, the tendency would be toward universal government wage-fixing—toward a rigid and regimented economy.

### PUBLIC MADE HELPLESS

How would the compulsory awards be enforced? It was already illegal for the New York City transit workers to strike, but when they contemptuously defied the law and the public, nobody dared to penalize them.

But if we should not try to impose compulsory arbitration, if we cannot forbid strikes, and if the imposition of longer back-to-work “cooling off” periods merely postpones the eventual capitulation to excessive union demands, is the public helpless?

We are so only to the extent that we have made ourselves so. In the last 40 years, through the Railway Labor Act; the Norris-LaGuardia Act; the Wagner Act; the Taft-Hartley Act and an incredible set of National Labor Relations Board decisions, we have taken nearly all the major risks out of strikes. We have made employers almost powerless to combat them. We have given unions special privileges and immunities. In brief, we have built up enormous irresponsible union power.

Yet Congress not only refuses to repeal, revise, or even to re-examine any of these laws; it acts and talks as if they had nothing to do with the recent epidemic of irresponsible strikes. ☸

## Parting Words

September 12, 1966

In September 1946 I wrote my first regular column for *Newsweek*. Now, just twenty years later, I am writing my last.

This twenty-year record, I confess, is overshadowed by the phenomenal performance of my colleague Raymond Moley, who in 1963 rounded out 30 years on *Newsweek* without missing a single issue, and is still at it. But this leaves me the runner-up for continuity among *Newsweek* columnists, and I'll have to settle for that.

My twenty years on *Newsweek* have been very pleasant ones. I have enjoyed complete freedom, within self-imposed bounds of good taste, to say what I want. Except for a special post-election issue once in four years, and one or two issues devoted to a single subject, no editor has even suggested what topic I should write on. No one, without my consent, has even changed my particular wording. When one considers how probable it is that the editorial management of *Newsweek* has not always agreed with me, my case is an impressive illustration of the full freedom of expression enjoyed by the *Newsweek* columnists.

### FREEDOM OF WRITING

This respect for the integrity of the individual writer, I am happy to say, is not confined to this magazine. For twelve years prior to my service here, I wrote editorials for *The New York Times*. These voiced the opinions of the newspaper, and were of course unsigned. Yet at no time there was I ever asked to write a sentence that I personally did not believe to be true. And this was the situation also on the New York newspapers I worked on in my vicissitudinous youth—*The Wall Street Journal*, the old *Evening Post*, the *Tribune*, the *Evening Mail*, the *Herald*, the *Sun*—all but the first, alas, now deceased.

I do not think my experience has been exceptional. No doubt there are newspapers and magazines that try to tell their editors what to write, and that run items or opinions primarily to please the advertisers; but they represent a sort of journalistic underworld, and are certainly not typical.

I am grateful to the many readers who have taken the trouble to write to me about my columns or the subjects with which they dealt. I tried to answer all letters that were reasonably polite. Naturally I have liked the praise and the expressions of agreement; but I have found even most of the hostile letters helpful. At the very least they have usually called my attention to some point that I failed to make sufficiently clear.

One point that I have apparently often failed to make sufficiently clear, judging by some of these letters, is that, when I criticize some alleged “liberal” or “anti-poverty” measure, I do not do so out of callousness, or because I have any less desire than my correspondents to reduce poverty or increase aggregate real wages.

### SHORTSIGHTED CURES

I have opposed minimum-wage laws, for example, because the main effect of such laws is to create unemployment. They increase the incidence of unemployment most of all among teen-agers, the unskilled and Negroes. I have often defended employers, because they are the ones who provide employment. To get full employment it is necessary not to destroy incentives for employers—a necessity that self-styled “friends of labor” too often forget. I have opposed excessive corporate and personal income-tax rates because they seriously reduce both the funds and the incentive for new investment. Yet it is above all the rate of new investment that directly determines the rate of increase in labor productivity and in real wages.

In brief, I do not differ from my “liberal” correspondents in their goals, but simply in their proposed methods of achieving them. In trying to bring about some wished-for result directly and immediately, they

too often fail to see that the ultimate results of the policies they propose will be exactly the opposite of what they desire. The difficult problem we face is how to mitigate the penalties of misfortune and failure without undermining the incentives to effort and success.

I shall shortly begin a twice-a-week nationally syndicated column. Yet it is sad to leave old associates and friends. I thank the readers who liked my articles for their thoughtfulness in writing to say so, and those who didn't for their forbearance. ❀



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