IS CAPITALISM DOOMED?

By **Lawrence Dennis**

Mr. Dennis writes from the vantage-point of intimate experience, both with the diplomatic activities in the United States diplomatic service in South America and as a former associate in a prominent investment banking-house in New York. His discussion of our present economic difficulties is therefore thoroughly realistic and practical.

His analysis centers attention on the fields of investment operation, the agricultural problem, international trade, and problems of foreign loans and debts.

He shows the interrelation of these problems and makes interesting and valuable suggestions as to public and business policy in these several fields, which might protect us from the dangers otherwise present of a collapse of the capitalist system.

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By

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PREFACE

REALISM, logical consistency and emotional sincerity are the aims in the method of this book. As it has nothing to sell, no conscious use is made of the gentle arts of suggestion or persuasion. The reader is invited on an intellectual adventure into the realm of economic realities. Where the realities are offensive, the presentation has done nothing to make them less so. The reader is asked to think and to follow the logic of the argument—not to agree with it. The book professes to contain no body of eternal verities to save the world and seeks to make no converts to a new economic faith or plan. Its only dogma is that people must think realistically and feel sincerely about the problems of the world depression in the midst of which the book was written. The purpose is to stimulate such thought and feeling. Wise action, it is believed, must spring from clear thinking and true feeling, that is, feeling which is true to one's self.

Thinking which aims to be practical can never be fruitful. Thinking must aim at truth and proceed with indifference to other considerations, particularly to that of an immediate success. The truth reached, of course, is always subjective and of less importance than the mental and emotional processes used in arriving at it. Compromise is often desirable in action but never in thought or feeling, where complete integrity is essential to personal happiness and social progress.

Social thinkers whose main objective is to secure acceptance of a given thesis or, as it is often called these days, a "plan," really make up both their minds and their plan to suit their public. This is often regarded as constructive thinking, which is just what it is not. If the plan gains acceptance, it is hailed as a personal triumph and a substantial contribution to human progress before the results of application can be determined.

A nation can stand "practical" solutions just so long and

then it has to blow up in a war or a revolution. The notion that the proposals of easiest application are the most practical is a popular fallacy. Whatever people want to do is usually practical. Leadership is largely a matter of making people want to do things in new or better ways, not in drafting plans to conciliate prevailing prejudices. The Dawes Plan was a "practical" solution for war debts and reparations. Selling on credit with high interest charges was a "practical" means of assuring an adequate market. The compromises that preceded the American Civil War were "practical" solutions of the slavery question by practical statesmen. But, for how long?

Some practical solutions are sound and others are not. The fact that any course of action is momentarily practical should never be considered as a reason for its retention. If progress is to be made without revolution, habits of dealing courageously with problems must be developed. Healthy evolution ought not to be frustrated by so-called practical solutions. Revolution is but long pent-up evolution.

The economic miseries of the world and the growing menace of war are signs of the times which are here discussed realistically, not for a sadistic joy in making certain people wince. The feeling which has inspired a realistic rather than a wishful treatment is that the way to avoid meeting the unpleasant in experience is to anticipate it in thought and discussion. Realities are rarely as unpleasant on paper as they can be in experience.

It is understood that among influential people, especially in America, England and Germany, the dominant feeling is that one must be practical and that practical means taking a view of facts which best enables a person with a delicate conscience to act effectively in carrying out a preconceived plan. The theory of this book is that people need a practical philosophy rather than practical plans. A practical philosophy is one that is essentially true to the people. It is a notion of their objectives which they can believe without internal conflict. Given this realistic philosophy, the people will take a realistic view of their situation from day to day. In the light of these changing views they will try to pursue rationally their objectives which should always

be changing with the situation. It is easy to justify wishful thinking in the creation of one's future paradise but not in the formulation of one's daily course of action in this world.

Never has wishful thinking been practiced more devotedly than in the United States during the post-war period. Never has a country been more completely under the domination of so-called practical statesmen and practical business men. We have lacked philosophy, spiritual leadership and effective discussion of present-day realities. Courageous facing of facts has been outlawed in positions of responsibility as a form of dangerous radicalism, while smug rationalizations have been extolled as constructive thought. In consequence, though we never had better information, we are neither clear as to our objectives nor in command of our situation. We know neither where we are nor whither we are drifting.

Our leaders, however, continue to bid us have confidence. It is appropriate to inquire, "In what?" "That the frontier era of the United States will have a rebirth?" "That the world will have a new industrial revolution?" "Or that another world war will afford us a fresh spell of profiteering and inflation?" We do, indeed, need a faith, but it must be in something more satisfying to the spiritual nature of man than the rising values of credit inflation.

It should now be apparent, even to the most confirmed optimists, that the ruling type of political and business leadership has not been guiding our destinies in a happy direction. Granting that our leaders are doing their best, it seems that the time has come to know the worst about their limitations and the situation into which they have led us. Unemployment and the menace of war have certain realistic bases that do not yield to psychological technique.

The Paris audience which, on November 27, 1931, howled down a series of distinguished French and foreign speakers may have rendered a greater service to the cause of peace than the peace speeches they stilled. Manifestations of French or German nationalists are valuable because they are genuine. They

are emotionally sincere and honestly expressive of a human sense of great fundamentals. Such virtues are conspicuously lacking in most of our professional peace advocates, handshaking politicians and bond-selling bankers.

It seems that the time has come to talk economics and peace in terms of reality and emotional sincerity. The realists may then become interested in the discussion. After all, it is the realistic nationalists who start wars and it may be that only they can keep the peace. These realists want peace and welfare. The ultimate problem is one of developing realistic formulas to live under, instead of shams like the Peace of Versailles, the League of Nations, the Kellogg Pact and the Young Plan to talk about. This book is not primarily concerned with formulas. They come last and are easily achieved, once the realities have been honestly met and the right states of feeling have been developed. These right states of feeling between peoples can never be founded on illusions or concealments; there are too many realistic patriots ever to make a success of any of the unrealistic peace plans. Doubtless our peace-loving friends are sincerely desirous of inspiring right states of feeling when they employ with unpleasant realities the technique of the advertiser. Unfortunately, or perhaps fortunately, the souls of patriots do not respond in these matters to purely commercial methods. Realists demand cards on the table.

Because this book is intensely realistic, its subjectivity is nowhere dissimulated. The social scientist who affects objectivity is not unlike the celibate who boasts of an objective attitude towards the opposite sex. In the first place, the poor soul is always the victim of self-deception about an emotional objectivity which, in these matters, is humanly unattainable; and, in the second place, lifelong inhibition and self-deception completely warp all judgments on that subject. This book proceeds on the hypothesis that all observation of, and reasoning about, social phenomena must, in the nature of things, be purely subjective and that in consequence, the reasoning which proceeds with the greatest emotional sincerity is best calculated to prove socially useful. Objective validity is the most subjective concept

that certain thinkers on social subjects have given us. Subjective as this book is, it does not go quite so far as to indulge in that particular species of self-delusion.[1]

The thought of this book has not been hastily formed. It is partly the product of practice and observation in diplomatic and banking career of wide travel and long foreign residence, and partly the result of study and research. The preparation of the book for final publication, however, was rapidly executed. It is, therefore, to be feared that minor errors in figures or phrasing of certain ideas may escape revision. No excuse is offered for such defects as might mar the absolute exactitude of the book, but the hope is expressed that they may not divert attention from the larger ideas which do not rest on any one or two statements of fact, but on an interpretation of a broad situation.

Finally the author desires to express deep appreciation of the courtesy of Messrs. A. A. Berle, Jr., Raymond Leslie Buell, Calvin B. Hoover and S. L. See for having read the manuscript and having offered extremely helpful criticisms. Needless to say these criticisms contained much dissent with many of the arguments of the book. The author, naturally, has sole responsibility for everything in the book.

INTRODUCTION

CHAPTER I

SOCIETY'S BUSINESS FAILURE: INADEQUATE MARKETS

THIS book is an attempt to look realistically at the capitalistic system in the present world depression. The point of view taken may be expressed in the following three propositions: First, that the capitalistic system has not failed in service, but that society has failed in command of it. Second, that if this social failure continues, the private enterprise system must sooner or later be replaced by some system of economic dictatorship, which will eliminate the intolerable condition, known only under modern industrial capitalism, namely, unemployment and want in the midst of unlimited productive capacity. And, finally, that there are values, justly cherished by many people, such as individual initiative and personal liberty, which, according to all indications, can be more freely enjoyed under capitalism than under any system of economic dictatorship.

The thought of the book, realistically rather than optimistically advanced, is that those who love liberty might well consider whether something may not be done to preserve the régime of private enterprise from the fate towards which it is now being conducted by business leadership.

Business is a good servant but a bad master. Business men are good at furnishing things but poor at inspiring people. Defenders of business have always been able to point with pride to its useful services. Its critics have had no less ease and satisfaction in proving its inadequacies. As long as it could be taken for granted, in the absence of an example proving the contrary, that no other system was feasible in the existing economic situation, the debate between the friends and foes of capitalism had only academic interest. Today that situation no longer exists.

Communism may not have justified its spiritual values in the

eyes of most people, but it has proved the workability of its mechanics. Communism is quite as practical as capitalism, a fact, however, which should constitute no argument in its favor. Cannibalism and war are practical. We should from now on be spared the silly argument that capitalism is practical. Whatever people want to do is usually practical.

Under communism the Russian people are producing more and saving faster than before the war. They are the only large nation in the world without unemployment. In 1929 the physical volume of production in Russia showed a 123 per cent increase over that of 1925, while the corresponding figures were 14 per cent for the United States, 13 per cent for Great Britain, 22 per cent for Germany and 30 per cent for France. (Memorandum on Production and Trade. League of Nations, 1925-1929.) It should also be borne in mind that the communists had the most backward country in Europe as a laboratory for their experiment. Creation of new economic machinery has been the big problem for Russian communists. In highly equipped and efficiently organized countries like the United States, Great Britain and Germany, the only real problem for a dominant communism would be that of administration, an art at which the communists have certainly displayed neither weakness nor ineptitude.

For the first time, therefore, capitalism faces the challenge of the reality of communism. Business is quite as much on trial as communism.

The most essential aspect of the social failure to command business is inadequate markets. The statistical facts are the highest unemployment figures, lowest money rates and smallest amount of new investment in this century; falling prices, lower wages, and steadily declining business earnings.

Inadequate markets, for the purpose of this discussion, are those which do not absorb a volume of production necessary to enable everyone to maintain a decent standard of living. In an adequate market the right quantities and the right sorts of goods and services must meet the right volume of purchasing power. The adequacy of the total volumes to the demands of

welfare and their meeting each other in the market are the two fundamental requisites for good business as well as for good living. The objective, however, must be good living and not good business. The pursuit of good business, as will be shown throughout this book, will always end up in the destruction of business.

As for a definition of a minimum standard for decent living, it may be said that this will vary according to the people, their ways and resources. Sociological studies are in general agreement that a large percentage of the American people—between a third and a half, according to different estimates—are at present existing below a minimum standard for decent living. This is an essential business as well as a sociological fact.

A basic premise of this book is that the standard of living should go on rising in measure as the productive efficiency of man increases. To say in palliation of the present crisis that the standard of living in America is higher than it was fifty years ago or than it is today in Portugal or China is entirely beside the point. There has been a steady rise in the per capita output of labor throughout this century, and particularly during the past decade, thanks to improved technique, new machines and a greater use of power per worker.

Since 1929 nothing has happened to our resources, to our capacity to produce, or to our taste for good living. Yet, with an increased productive capacity and a stronger desire to consume, we find our engineer president preaching economy in government and his business colleagues practicing it in industry by throwing thousands of men out of work, reducing wages and cutting down expenses. Rich investors are reducing their consumptive expenditures and curtailing new investment in industries which are being depressed by such a widespread practice of economy. Gold reserves have been accumulating in the creditor countries, yet they have been contracting the volume of credit, forcing down prices and paralyzing economic activity. The American standard of living is falling. The rich are economizing and the poor are starving. Yet our productive plant cannot market its output.

The statement, at first made as the depression began to be felt, to the effect that wages are only being reduced to keep pace with falling prices is largely untrue. United States Commissioner of Labor Statistics Ethelbert Stewart, following a survey of declines since December, 1925, in the indices making up the living costs of the average workman in the manufacturing industries stated[1] that, between 1925 and 1931, the cost of living of the American workman had declined 15 per cent while the total amount paid out in wages by manufacturing industries had dropped 40 per cent.

Between the idea of an adequate market laid down in this discussion and that of the business man there is a capital difference. Slavish adherence to the seller's view of the adequate market is mainly responsible for the sterility of most discussions of the economic depression. The problem is everywhere studied as one of improving business or selling what producers have to sell. Business is spoken of as though it were a sort of deity which was now, for some not clearly understood reason, dealing harshly with its votaries. It must, therefore, be placated with human acts and sacrifices. In this matter the wage earner is the clearly marked scapegoat. The god is especially pleased with wage reductions, less government spending and lower production costs.

Now the only trouble with propitiating the great god production is that his priests, the business man, never seem to know exactly what the god wants. The only intelligent answer to the question, What do business men want? must be Profits. Any suggestion a business man may advance in a time of depression will be conceived in the light of his individual problem as a profit maker and with a view to its immediate solution. Every business man naturally reasons that his troubles would be all over if he could produce and sell 10 per cent or so cheaper. This reasoning, of course, is entirely fallacious when applied simultaneously to a large number of cases. Reducing production costs 10 per cent all around cannot possibly leave

[1] *New York Times*, October 3, 1931, page 1.

business any better off than it was before, because prices will go down in proportion.

Listening to business suggestions for improving business increases the chaos of the general situation in so far as attempts are made by government or concerted business action to do what business men recommend. Business men cannot even agree on any sensible plan in homogeneous industries like oil, copper, sugar or rubber production. During the war government had to establish economic dictatorships in order to secure orderly production. If left to themselves, business men must always bring on a crisis which, in turn, will only be broken by the play of purely non-business forces like war or the opening up of a new continent.

It is not the fault of business men that they give impossible advice as to what to do for business. It is the fault of the people that they are so destitute of spiritual leaders as to ask or pay any attention to the advice of business men. Business needs to receive orders—not to give them.

Much popular confusion about business grows out of failure to recognize that business is neither a state religion nor a complete scheme of human destiny. Business must rely on the play of great spiritual forces for the creation of an adequate market. Business leadership alone can never provide a solution for an inadequate market. In the remainder of this chapter an attempt will be made to explain briefly why so much has been expected of business leadership and why these expectations must always be doomed to disappointment.

Business is a competitive game of profit-seeking and not a cooperative way of promoting human welfare. Love of the game, love of activity, love of power and love of lucre are the dominant motives in business enterprises. The driving force is human greed. The technique is human cunning. Such a system calls for moderation and practice under the effective play of strong factors of social impulse, guidance and restraint.

The charm of capitalism is that it may be practiced in a way to allow of a varied and balanced civilization. When business leadership becomes dominant, balance is lost. The economic

stress has become more acute in the United States than in Soviet Russia. And while Soviet Russia has solved its market problem, the entire capitalistic structure is threatened with collapse because the market problem has become well nigh insolvable in the United States.

In a communist society it is impossible to have too much communism. For communists there is nothing else here or hereafter to have. Communism offers a way of attaining everything thought by communists worth while from the cradle to the grave, points within which human destiny is definitely circumscribed by the communist faith. Moreover, unlike business, communism is a system which its adherents understand and know how to operate. The system rules out individualism, greed and profiteering. It is, therefore, susceptible of social and cooperative practice.

But business is business. It is a competitive way of making money out of the satisfaction of human wants and the exploitation of human weaknesses. It is not a complete way of life. The business man is a trader, not a prophet. As a trader, however, he is quite as much a spiritual being as a poet and, usually, a great deal more of a mystic. He dreams dreams and sees visions, but they are always visions of profits. The idea that business men are rationalists or materialists is absurd. The nature of their occupations makes business men feel a greater need for spiritual certainty than most men. When a business man has money ventured on a given enterprise, he needs certainty that he is going to make money. There is, of course, only one way to enjoy certainty about the future and that is to have faith. So it happens that business men live by faith, just as scientists live by investigation or soldiers by discipline.

The business man moves in a subjective world of fictions, hopes, invalid assumptions and dreams. Theorists live in a world of facts and reasonable conjectures. Facts, of course, gradually creep into the business man's creed, long after they have been proved by theorists. And there they linger long after they have been disproved by subsequent generations of theorists. Theorists recognize, naturally, that facts are always changing.

Practical business men, especially when their money is at stake, cannot admit any change in facts. They must, therefore, like all believers who are worried about the future, meet facts with the dogmas of faith. If a business man risks money on the assumption that the price of copper is going to be 18 cents a pound, his mind must be as closed to 6 cent copper as the mind of a fundamentalist is to the possibility that the plants may not have been created before the sun.

American business men owe no small part of their moral authority and leadership in the American community to the fact that for more than a decade they have been the only important group of Americans who have had something to believe in and have not been afraid to proclaim it enthusiastically. Human beings will be led only by men of enthusiastic faith. A faith that United States Steel would pass $300 was, after all, better than no faith at all.

American business men and Russian communists have been about the only dynamic believers left in the world since the disillusioning of the liberals after the World War. Since 1929 the dynamic believers left have been the communists. But the business men are praying hard for a revival of faith which will bring their customers back into the market. At the same time, they must reduce their customers' wages.

The majority of the educated Protestant clergy have been distinguished more by doubts and caution in expressing them than by inspiring beliefs or ideals. The fundamentalists have been out of step with their generation. American scholars have been, for the most part, passionless collectors of what they call data, as devoid of a living faith or a strong conviction as they have been lacking in directive influence on American life. They have inspired neither generous enthusiasms in the young nor confidence in the old. What financial patronage they have received has been accorded not for their spiritual contributions but because of their assistance to productive efficiency or their usefulness as technical consultants.

Now, although the business man in American has been our chief inspired believer, his faith has belonged to a frontier

era which has passed. Our national god has fallen. The American business faith could burn brightly only as long as new oil wells gushed easy fortunes and as long as unearned increment on land due largely to heavy immigration or credit inflation assured wealth to those who merely bought and waited, blunder as they might. Only a fool-proof prosperity can sustain a business faith. The World War staged for the United States a return engagement of the frontier era, which had passed before the end of the last century. The crash of 1929 rang down the curtain on what will probably be the last return engagement of this popular drama.

A business man's spiritual nature cries out for the certainty, not only that he is going to make money, but also that his operations are good in themselves. This faith probably strengthens business leadership over the people and undoubtedly influences business behavior, for the worse. Up to the commercial revolution, or, roughly speaking, the seventeenth century, trade was not important. Up to still more recently it was not considered respectable.

The mental attitudes formed in the days when bankers and tradesmen felt the sting of social ostracism have, however, persisted. They still influence modern thinking and behavior. Centuries of the ghetto have given to modern business an inherited inferiority complex. The contributions of the British economists were, no doubt, inspired in part by a desire to dignify and rationalize pursuits which were looked down upon by the ruling classes and which were felt also not to be any too well seen by the Almighty.

It was necessary in a theological age, deeply tinged with Calvinism, to establish for business men a body of doctrine which would justify both their passage through the pearly gates and their admission to polite society before they got there. They have now passed every social barrier on this earth, but, from their long and unpleasant wait in the antechambers of respectability, they have developed an extreme sensitiveness about the dignity, morality and social utility of their activities. The purely objective view that any act of trade may be either

good or bad, and that it derives its character from circumstances and the consequences for society, does not satisfy the emotional requirement of the average business man. He demands a spiritual certainty that all trade within the law is a good thing in itself, and he wants the law to be as broad as possible.

Some four centuries ago Jean Calvin wrote: "What reason is there why the income from business should not be larger than that from land owning? Whence do the merchant's profits come except from his own diligence and industry?" The United States Supreme Court in a decision upholding short selling ruled as follows:[2]

"People will endeavor to forecast the future and to make agreements according to their prophecy. Speculation of this kind by competent men is the self-adjustment of society to the probable. Its value is well known as a means of avoiding or mitigating catastrophes, equalizing prices and providing for periods of want. It is true that the success of the strong induces imitation by the weak and that incompetent persons bring themselves to ruin by undertaking to speculate in their turn."

In so far as the court held that, in the present pattern of economic institutions, short selling was desirable, it was on sound ground. For its economics, however, the honorable court might better have gone back of Calvin to the Biblical story of how Pharaoh prepared for the seven years' famine. The only known means of "providing for periods of want" is production and saving, not selling short. Speculation does not avoid or mitigate catastrophes, equalize prices or provide for periods of want, so far as society is concerned. If speculation at times yields these benefits to the lucky short seller, it far more often inflicts their exact opposites on the unlucky. But, as the court had to uphold short selling, its evangelical conscience compelled it to evolve a lot of unrealistic economic theory, or theology, in justification of short selling.

When evangelical or Judaic business men say that something is good for business, they must feel the same spiritual reaction

[2] Board of Trade v. Christie Grain and Stock Company.

that a patriot experiences when he exclaims that something has been done for the fatherland. The frequency in American speech of the expression "good for business" and the invariable moral earnestness with which it is uttered evidence the survival of this emotional attitude. How odd it would sound to hear people saying that something was good or bad for humanity, civilization, religion, art or even sport! One does occasionally hear the expression in regard to sport.

The spiritual need of the business man in this country for the certainty that his activities are going to be not only profitable to himself but pleasing to the Almighty, leads to business romancing, often enough by persons with whose personalities it seems difficult to associate romantic feeling. Romance, of course, is a rare and beautiful essence which, with a sufficiently subtle alchemy, can be distilled from almost any element, possibly even from trading for profit. At any rate, it would be most ungenerous to deny to business men a spiritual joy in business which they may not find elsewhere. Certainly traders have been somewhere in the picture in every romantic scene of modern history. They have followed every army, discoverer and pioneer. Where the scientist or inventor has opened new fields for human activity, the business men have promptly rushed in, staked off claims, and started profitable exploitation.

Everyone must find his romance where he can. The only criticism to be made of business romancing, perhaps, is that the subject is most advantageously viewed through the glasses of reality. A romantic disregard for facts may be highly propitious to the natural culmination of gallant enterprises, which are extremely subjective affairs.

In discussions of the purely technical phases of business, business men are apt to be as tediously factual as the scientists, but as soon as the discussion touches the relation of business to society or to a broad outlook, such as the late "new era," business men suddenly go off on a romantic or evangelical tangent. Now, these sermons or romances about business are peculiarly irrelevant to the fact of six million men employed in 1931, or 6 billion dollars out on call in 1929, or eight thousand bank failures in a decade, or making the American taxpayer pay for

eleven billion dollars of war goods sold on credit by profiteering business men.

If business were not, as has already been tediously pointed out, a venture in profit making, one might say that it needed the scientific realism of the laboratory. The modern business man, however, must be the spiritual grandchild of Merlin and Cagliostro. The economists who made up the weekly letter of the investment banker, encouraging investors in 1929 to buy stocks at several times any reasonable price, correspond to the hired knaves of the fifteenth century alchemist. They are the auxiliaries or prostitutes of a black magic, whereby money is supposed to be made by plotting rather than plodding.

The unromantic fact about the processes of trade is simply that they have no moral quality in the abstract. An act of exchange creates wealth only in so far as the things received in exchange by both parties yield them greater satisfaction than the things they give in exchange. If both parties derive satisfaction, there can be no doubt as to the wealth or utility creating quality of the trade, be it domestic or foreign. If what one party gains, the other loses, as must occur over the long run in all stock market transactions, it is obvious that the act of exchange produces no wealth. If both parties are less satisfied, or if the satisfaction of one is more than offset by the dissatisfaction of the other, the trade has clearly created disutility or the opposite of wealth.

The most obvious illustration of exchange producing wealth is the classical example of the two men on the desert island. One grows more potatoes than he can eat, but no cabbage, which, however, he greatly relishes. The other grows more cabbage than he can eat but not potatoes, which he also likes. It is evident, then, that the quantities of cabbage and potatoes exchanged acquire value, or become wealth only by reason of the exchange. It is equally clear that much trade that goes on every day has this wealth creating character; and it is no less certain that a great deal of trade has not this quality, notably most trade that occurs in the speculative markets.

Casting the glamour of romance or theology over the processes of trade, however, can never make business leadership

adequate or business a complete scheme of human destiny. Welfare must always be a matter of pursuing a series of spiritual objectives according to some scheme of life, no matter how simple or strange. Business ways may serve the ends of welfare by supplying an abundance of goods at low economic cost, but profit-seeking can never generate the necessary impulses to sustain economic activity. All of this amounts to stating that business cannot solve its own market problem. Probably the wisest utterances from any high place with regard to the present depression have issued from the Vatican. This wisdom has consisted in the simple fact that it has expressed concern over the welfare of human beings and not the recovery of the thing called business.

The problem of society is the pursuit of happiness according to some scheme of values. The problem of business can only be the competitive pursuit of profits through the satisfaction of human wants and the exploitation of human weaknesses. The pursuit of these conflicting objectives must always involve a conflict between society and profit seekers. This conflict, however, need not be one of extinction. It may be merely a rough game. Business seeks maximum profits for minimum service and society seeks maximum service for minimum profits. If the game is to continue, it must be conducted with due regard for human rights, one of which is that of earning a living by honest toil.

Those who play on society's team, the government, must be as loyal and effective as the players on the business team. If the representatives of the people had played the game, we should not have six to eight millions unemployed in the richest country in the world. We should be able to consume as much as we are able and anxious to produce. Unfortunately, the representatives of the people have played on the profit makers' team and boasted of it as cooperation. This sort of thing is called collusion and corruption in the little bouts our law courts umpire. Two opposing teams are not supposed to cooperate. They are expected to play hard, but they are supposed to play the game.

PART ONE
FINANCE

CHAPTER II

PROSPERITY BY DOMESTIC INFLATION

IF CAPITALISM is to endure, society must develop adequate measures to assure steady and full employment for capital, management and labor. Such employment is essential to the maintenance of a decent standard of living. Past experience and the present situation furnish evidence that business knows but one way of running production at full speed, namely, credit inflation.

From the point of view of society, the principal defect of prosperity by inflation is that it cannot be kept up. The breakdown comes in credit and not in production. This fact is the big point of this chapter, and one of the ideas running through this entire discussion of society's relation to business.

After a few years of intensive use, the device of credit becomes, during a protracted period, unworkable as a further stimulant to production. We are now agonizing in this latter period. It is one of depression, unemployment, bankruptcies, foreclosures, bond defaults, debt cancellations, and an extinction of capital values for which many poor investors have paid a lifetime's savings. All these tragedies must occur in the credit cycle at certain intervals to make it possible for business men to be able to start inflation all over again as soon as something like a war or a gold rush furnishes the necessary spiritual impulse.

The reason why the debt slate has thus, periodically, to be wiped nearly clean is not that the preceding uses of credit have been unproductive. On the contrary, the trouble seems to be that there has been too much production of certain things. The realist concludes that the reason why a large amount of debt has to be canceled in periodically recurring seasons of prolonged depression is none other than that a large volume

of debts can neither be paid off nor borne by the interest payers. He, therefore, asks, Why create a large amount of debt? But this is getting ahead of the story.

Debt creation seems to set in operation the following anti-debt processes: (1) overproduction, which causes price declines in the debtor's produce; (2) the inexorable play of compound interest whenever interest payments cannot be promptly met out of production; and (3) the effects on consumptive demand produced by interest payments from an army of debtors to a handful of creditors.

Credit inflation seems, therefore, not only a dishonest and anti-social way of financing a necessary volume of production, but, at best, a temporary makeshift. An enlightened people should demand perpetual prosperity. There is no valid reason why they should not enjoy it, subject only to the limits of natural resources and the people's capacity to work. So runs the argument of this chapter.

Let us look at the facts. Credit inflation has been the instrument for the fabrication of American prosperity since 1914. Let it not be supposed that our bankers decided in 1915 that the time had come for the nation to be treated to a spree of credit inflation, and then proceeded to carry out this amiable decision. The war started in 1914 and, as usual, the bankers did not know what it was all about, but slowly they discovered what fun it was selling to European belligerents some 16 billion dollars' worth of supplies on credit. These phenomena will be discussed in the section on foreign investments. The bankers thought this could go on forever, and so they made loans on sugar at 15 cents a pound as late as the beginning of 1920. The crash of that year served to impart to the bankers information which the armistice might have conveyed to more philosophical minds, namely, that the war was over. This depression did not last long as the bankers gradually discovered that with a doubled gold supply, as a result of our war profiteering, we could support an agreeable amount of interest bearing debt inflation. The academic rationalizers, of course,

supplied an adequate body of evangelical doctrine to justify all this inflation and the salesmen rose to the opportunity. To make a long story short, we financed by the creation of some 72 billion dollars of interest bearing debt in the ten years 1920-1929 a perfectly splendid internal credit boom.[1] About 10 per cent of the purchasing power used for the purchase of movable goods between 1920 and 1929 may be thought of as the product of a net increase in the total volume of outstanding debt.

In 1929 the estimated debt of the United States, as itemized in the footnote below, was about 194 billions. According to the estimate of the National Industrial Conference Board[2] the national wealth in 1928 was 353 billions, or 252 billions in 1913 dollars. By the end of 1931, our national wealth was doubtless near 200 billions in pre-war dollars. The money lenders, therefore, will practically own the country if prices continue to fall and debts are not wiped out by cancellation. It may be remarked in this connection that Sir Ernest Benn estimated at the opening of 1931 that Great Britain's total debt greatly exceeded her national wealth. The fact that most of our national wealth may be considered today as potentially belonging to money lenders is highly significant because of the effects of the obligation to transfer so much money in interest payments, whether earned or not, from so many debtors to so few lenders.

[1] CREDIT INFLATION 1920-1929.

Sources: Items 1 to 3, "Credit Expansion 1920-1929" by Charles E. Persons, *Quarterly Journal of Economics,* November, 1930.

Item 4. Agricultural Yearbook, 1931, United States Department of Agriculture.

Units of $1,000,000	*1920*	*1929*	*Increase*
1. Urban real estate mortgages	$11,070	$27,106	$16,036
2. Corporate bonds and notes and public securities. These figures take account of the reduction in the federal debt	61,900	99,600	37,700
3. Commercial bank credit	41,685	58,417	16,732
4. Farm mortgages	7,857	9,470	1,613
Total expansion of interest bearing debt in ten years			$72,081

[2] Bulletin 51, March 20, 1931.

The figure of 72 billion dollars of debt increase, intended to be suggestive rather than exact, does not include the offerings of over 16 billion dollars of new common and preferred stocks, nor does it give any idea of the fantastic 80-billion-dollar increase in market value of listed securities which occurred during the two years prior to the crash of 1929.

Most of the inflated market value of stocks was, naturally, fictitious, corresponding to no comparable increase in earnings. The psychological effect on personal spending produced by inflated market values cannot be easily measured. It seems fairly certain, for instance, that a man, who in September, 1929, owned a hundred shares of National City Bank Stock then worth at market $55,000, which, in no remote past, may have cost him four or five thousand dollars, was likely to be influenced by the fact of this fictitious value to consume in September, 1929, a larger part of his realized money income from all sources than he would have consumed in December, 1931, when the same shares were worth $3,600. A man's idea of how rich he is must exert an important influence on how much he spends. And, market quotations are "facts."

The effects of credit expansion on national prosperity have been admirably expressed by Professor Persons in the following terms:

"When every potential debtor and installment buyer has assumed the full burden of indebtedness, which the new credit policies allow; when every would-be home owning family has purchased through the building and loan association as costly a house as its resources will permit; and when every apartment house and business building has been burdened with as heavy a load of bonded indebtedness as the avid savers and investors can be persuaded to accept,—in short, when the newly tapped credit resources have been fully exploited, there is, of necessity, an end to the process. While credit expansion continues we can produce, sell, and enjoy as much more than the annual money income as is covered by the increased debt burden. When expansion stops we snap back to the volume of goods covered by the national income. . . .

"Producers have been selling a volume of goods equal in value to the total national income plus 5% or 10% of new debt created. Sometime and at no long distant date they must return to the less spectacular but sounder basis of selling a volume annually equal to the national income in value. With all our Yankee inventiveness we may never hope to find a way to spend continuously more than we earn. [But, Professor Persons, is there any reason why we may not find a way to earn all we can produce?] For a few years the nation, like the individual debtor, may buy more than it earns, paying for the unearned balance by increasing its indebtedness. Once the limit of its credit is reached, the nation's purchasing power falls back to the limit of its national income."

It may be thought by some to be an overemphasis on one factor to say that our nine years' prosperity after 1920 was mainly a phenomenon of credit expansion. Many other factors may be cited as influential, such, for instance, as increased productivity per capita of workers, due to improved technique, new machinery and better selling facilities. But those who are disposed to minimize the importance of the credit factor are asked to bear in mind one point: We enjoy today full command of all the non-credit factors, yet Washington and Wall Street cannot extract from them one single drop of trade reviving elixir.

Now the contention here is that the idea that the United States since 1920 has been living beyond its income is invalid in every respect. Common sense should tell anyone that the real income of a nation is what it produces. The earned income of all citizens may be less than the cost value of the things consumed and new investments made. In our case, that numerous class of citizens who have been spending borrowed money have, undoubtedly, been living beyond their incomes—in money.

Of the United States, as a nation or as an economic unit, however, it would only be correct to say that it had been living beyond its income if one of the following two conditions could be proved: (1) That we had been borrowing heavily from

foreigners and living partly on an imports surplus, or (2) that we had consumed such a large part of our current production that we had failed to make due capital investments for the future. Obviously, neither of these conditions obtains in our case. We have been lending to, rather than borrowing from foreigners. If we had been living at the expense of the future, we should now be confronted by a shortage of houses, factories, ships or something or other. As it is, we are only short of jobs for the unemployed.

We have been living beyond the earned, though not the potential, money income of the people, it is true. This fact merely proves that the earned income in money of the people has not been large enough. To be forced to curtail production and consumption because our non-borrowed income was insufficient to pay for what we were able and anxious to produce, and because we had come to the end of our credit rope, is worse than a crime; it is an error. Such errors may be fatal to capitalism.

Through the collapse of a credit-made prosperity, our business leaders have forced on the nation, not only reduced production and consumption, which might be tolerable, but, also, unemployment, which is intolerable. Economists and business men have always lacked the human insight to comprehend that an abundance of healthy activity, of any sort, is the most essential thing to man's happiness. It is far more important than an abundance of goods. Obviously, where everyone has abundant work, there will never be a lack of the bare necessities of life, though the physical volume of production may be less than in an industrialized nation where millions of unemployed are starving. This paragraph does not state that abundant goods and abundant work are mutually exclusive. It states a comparison between the two. People must have work, and the necessities of life. They do not require an abundance of goods.

With regard to an abundance of goods, it is, perhaps, not inappropriate to recall that several great teachers, not without a considerable following, as, for instance, Jesus and Gautama

Buddha, have expressed strong convictions that abundant worldly goods are not essential to welfare. And a great Eastern poet stated that for his economic requirements he desired only a jug of wine, a loaf of bread and a book of verse. It would appear that he was both sincere and happy.

An acquisitive order can survive only if it assures ample activity to the masses, while the money grabbers play at their favorite game. Comparatively few people have highly developed acquisitive impulses, while nearly everyone needs activity. This fact has been lost sight of in the industrial countries, such as America, England and Germany, though considerably less in France, where an unbusinesslike people, who have cultivated the art of living, have steadfastly refused to allow efficiency experts to make one man do the work three men can do quite as well.

The problems of credit, employment and consumption are really one wherever a large use is made of credit. The joint discussion of these three problems may make this chapter somewhat confusing, especially to those unaccustomed to a close association in thought of the three. In America the expansion of credit has always been thought of as an aid to production. Even consumptive credit has been so rationalized. The problems of consumption and employment were just not considered in connection with the use of credit, or with anything else for that matter. They were supposed to take care of themselves in our efficient organization of society. Credit has been the salesman's friend and the banker's racket. It is now plain to see that credit has not solved, but, on the contrary, has aggravated both of these problems. Let us now see why credit prosperity had to fail. It is largely due to limitations imposed by the mechanics of credit.

Now, obviously, a net increase in the total amount of debt in a country will effect unerringly an immediate and roughly equivalent degree of correction of deficient purchasing power, to put it in this way. In the long run, however, and usually not a very long run, especially where interest rates are as high as they were during the late new era, the evils of deficient pur-

chasing power, or maldistribution of income, are aggravated to the full extent of the interest burden further imposed on interest bearers by fresh increases in debt. All this is fairly simple.

Here it becomes necessary to grapple with the productivity fallacy. In the new era any use of credit was justified by the incantation of the magic word "productive." Now let it be stated clearly at the outset of this critique that borrowing would create absolutely no difficulties and would justify the claims of the "productivity" school if the use of borrowed money always produced the money payments due—not just a certain quantity of goods or services. Obviously, most government loans, as those for war, and all loans to enable people to consume something now instead of waiting until they have saved up the purchase price, fail to create an income equal to their interest charges. The interest on such loans, or consumptions of goods, can in the long run, be paid only through a subsequent lowering of the standard of living of the debtors. Few champions of "productive" credit would contradict these facts though they would usually try to confuse the whole subject by talking about an increase in the interest paying capacity of the debtors. They omit, however, to explain that if the debt bearing capacity of the borrowers is enlarged, the causes, such as the opening of the industrial era or the development of a new continent, have not been created by the use of credit nor can they be maintained in the future by uses of credit.

When it comes to borrowing for production, the champions of "productive" credit imagine that they have made out an ironclad case when they have shown that a given use of credit causes, or, more accurately stated, coincides with, an increase in production equal, at prevailing prices, in money value to the added interest charges. Proofs of this sort of productivity supported the fallacy on which the "productive" foreign bonds, now in default, were sold to unthinking investors. This argument is always rendered worthless by one simple fact: prices fall and debts do not.

The whole case for the productive use of credit ignores two

simple facts: First, debts must be paid in money, not in the much advertised elements constituting "production." Second, debts have to be paid in money, regardless of whether the use made of the borrowed money has yielded the necessary money payments, or, for that matter, any money.

To state these incontrovertible facts and to develop the logic that inevitably derives from them, is not necessarily to argue for the discontinuance of all use of credit. It is to demand that all uses of credit be truthfully described and scientifically discussed for what they are: pure gambling operations, where they finance production; mechanisms for shifting the incidence of taxation from the rich to the poor, where they finance wars; and devices for making goods consumed cost more to consumers,—to the advantage of money lenders,—where they finance consumption.

In the case of a so-called "productive" loan, if it really produces a saleable commodity, importance attaches primarily to the fact that the operation is a pure gamble on the future of price levels. Prices will or will not be higher during the period of repayment. Prices were falling over some eighty of the one hundred twenty years from 1812 to 1931. The periods of falling prices in the United States and England have been 1812-1849, 1865-1896 (England 1873-1896), and 1920-1931.

Once it is recognized that productive borrowing is always a Simon-pure gamble on the future trend of prices, importance attaches not to the question whether credit is being used "productively" but to the question whether or not too much gambling is going on. Some gambling under the capitalistic system is, perhaps, inevitable, but it is a necessary evil which should be kept down, not encouraged.

In a word, borrowing stands condemned as a means of creating prosperity. Borrowing financed production, but what has it done to consumption and employment? The evils of large scale borrowing grow out of the distribution it always makes of the burden of capital losses as from wars and industrial mistakes. Borrowing effects a division of the national

income which is unfavorable to the maintenance of an adequate market.

To say that credit has been misused when things go wrong is pointless. Things must go wrong when too much use is made of credit. It is not the so-called injudiciousness of separate uses of credit, but the simple fact that there have been too many uses of credit that explains the ensuing difficulties. As no one can ever have a valid basis for saying how much is too much use of credit at any given time, a philosophical aversion to credit use is indicated. This calls for a pay-as-you-go policy and proprietor's capital instead of lender's capital.

The so-called abuses of credit are inherent in the institution. If anybody borrows, the state will surely be the biggest borrower. When there is a war, the rich will pay for it by buying government bonds. If they had to pay for it through a tax levy, they would, in most cases, prevent the war. And so, as Professor Seligman, the great champion of borrowing, correctly points out, war borrowing is usually necessary,—that is, for wars. The war creates no wealth or sources of money income with which to repay the loans. If the lenders are to be repaid, the masses of the people, who could not have furnished the money for the war while it was being fought, must over a longer period of years turn over a surplus of their production to the lenders. The lenders, however, do not consume this surplus. They prefer to let it accumulate in the form of additional loans, largely to the same debtors, all of which is, obviously, a nonsensical process. The French and Continental nations had the good sense to undo it by currency devaluation. The British, being guided by international bankers, were not so intelligent and are now paying dearly for the folly of financial experts.

To rationalize the absurdity of relending domestic taxpayers the interest on war and other profitless debts the asset fallacy is most useful. (The British, unlike ourselves, had not the gold to do much of this sort of lending between 1919 and 1929; hence their people had to suffer the unmitigated consequences of paying money lenders for the war.) The lenders of capital which has been sunk without a trace, whether in war,

consumptive expenditures of government or private persons, or in unprofitable business investments, really go on, for a time, lending the debtor class the compounding interest payments on debts which ought to be as extinct as the capital they represent. But these new loans are not connected with the deflation of war debts. In other words, their real function is not said to be that of offsetting the deflation caused by paying off the war debt. Oh, no. The new loans are connected with the creation of physical property. And it is conveniently forgotten that such creation of physical property is offset about 90% by current wear, tear and obsolescence. This is what is meant by our use of the term "the asset fallacy."

The asset fallacy is appealing. It is pleasanter to suppose that an asset pays a debt than that a person pays it. Obviously, people and not things pay debts. People pay debts with things. This, people accomplish by the rather simple process of consuming less than they produce or of producing more than they consume. The lenders can only get paid in reality by consuming, wasting or destroying this surplus production. Continued reinvestment of this surplus with a view to maximum profit-making must lead to an excessive amount of loss through investment, a process in the midst of which we now find ourselves. The evils of consuming the surplus in this way rather than through a more equitable distribution of income hardly need elaboration.

The asset-loan notion has validity only for pawnbrokers and for them only if they do a shoestring business. We shall see in the near future hundreds of thousands of American investors lose billions of dollars in gilt-edge railway, industrial and real estate mortgage bonds. But even these losses will perhaps not suffice to disabuse the minds of most people of the asset fallacy. It is hard for them to see that capital is entitled to a share of realized earnings only if there are any, and that an attempt to exact more out of the standard of living of the people is a bitter and, ultimately, a futile process. The only true economic asset is earning capacity.

Let us see how this asset-loan fallacy makes mystification

about credit inflation easy for bankers. In 1928, for instance, it may be said that the increase in the total debt of the borrowers of the United States was over 10 billion dollars. In the same period the creation of new physical assets represented a money cost of over 20 billion dollars. And it may be estimated that the expenditures of the American people on luxuries amounted to 30 billion dollars.

Now we have figures with the aid of which we can either defend or condemn credit inflation in 1928 as it may suit our purpose. To praise inflation, we need only to connect it with the increase in assets. To condemn it, we associate it with the expenditures on luxuries. If a government wishes in peace time to increase its military expenditures without raising more taxes, it borrows to build schools, roads or "productive" public works. If a middle class family which used to ride in the street cars now keeps two automobiles and one mortgage, the mortgage is extolled by the bankers and economists as a beneficent institution which enables that family to own its own home.

The realist finds an obvious connection between an increase in total debt and an increase in total production and consumption. He perceives no connection between total debt increase and a particular class of expenditures such as those for public works, factories, new homes or silk underwear. People, governments or corporations borrow to spend more money, not to spend a given amount on some particular object. The pity is not that they spend more, but that they have to borrow to do it, because they will later on have to spend less, by the amount of interest to be paid, than they might have spent had they never borrowed.

The social importance of a debt increase attaches not to how or why the money was spent, but to the effects of interest payment on the distribution of income and wealth. Spending borrowed money is an unmitigated blessing. It is paying money back with interest that constitutes the world tragedy of the moment. The mischief starts with the debtors having to reduce

their consumptions of goods in order to pay their debts. This is the "road back" from the bankers' credit road to prosperity.

The debt process creates added production and consumption only to the extent that the yearly debt increase exceeds current interest charges—to create productive assets, of course. But, asks the realist, why are productive assets not desirable today as well as yesterday? The unemployed are just as hungry now as they were in 1928. The answer, of course, is that the bankers cannot sell bonds in 1932. Therefore, we cannot have any productive assets, to speak of, in 1932.

Business men seem to think that man was made for the credit machine. And society has allowed business to conduct the machine on this assumption. The tragedy of so much ado in 1932 about the credit machine is that if the credit structure is as unsound as Mr. Hoover's measures would indicate, they will prove unavailing. On the other hand, measures to give work to the unemployed could be made effective in a few weeks, if there were a disposition to extend relief in that quarter.

Up to recently, the apologists of installment selling have been pointing with great glee to the fact that installment payments were showing a low percentage of defaults, even in the depression. This fact is precisely one of the many reasons why industry is depressed. Had installment debtors stopped paying their installments and had the courts found some pretext for invalidating all such obligations, the debtors would now be consuming more goods and trade would be that much better off.

In 1929 there was outstanding over 3 billion dollars in consumptive credit, on which consumers were paying well over 10 per cent. Let us assume that this volume of consumptive credit were to remain relatively constant. What would be the result for prosperity? In the first place, the institution would be creating no added purchasing power or consumption of goods. The institution would have made its only contribution to increase sales during the initial period of expansion. In the second place, consumers would be paying in perpetuity 300

million dollars a year in interest which they might be spending on goods had this institution not been inaugurated.

It will be objected by some defenders of installment selling that the recipients of the interest spend it on business goods. The assumption that investors must either spend or reinvest their full money income is refuted in another part of this book. The fact is, as Mr. Keynes says, that "The performance of the act of saving is in itself no guarantee that the stock of capital goods will be correspondingly increased."

If, however, the assumption is correct, it still remains true that installment buying does not, over the long run, increase sales by one cent. Assuming the best possible course of developments, it merely increases sales to money lenders and decreases sales to borrowers. If there is a lag in the reinvestment of interest, as is contended by this book, installment buying decreases the amount of sales to whatever extent the 300 million dollars of interest is spent less promptly and completely by money lenders than it would have been spent by the borrowers, had they not borrowed. In any case, the diversion of so much interest money from the borrowers to the lenders constitutes a grave social evil.

It may be said that without installment credit many a person could not save up enough to buy an automobile, even though the installment method makes him pay 10 per cent more in interest. The answer, quite simply, is that he will be better off without a car and so will the army of merchants who depend on his trade. He will spend the 10 per cent on other goods.

The tragedy of consumptive credit, as of public credit, is not non-payment, but interest payment. In the long run, a good part of the interest payments which the money lender receives, the manufacturer, merchant and worker will lose, because such interest money is taken out of the living expenses of the interest payer, and this process causes falling prices. The money lender who derives such an income will not spend or reinvest it all promptly, or he will make foolish investments. The point is that the borrowers who pay for wars, industrial mistakes, personal errors or a simple impatience to consume

have their economic power weakened thereby. Business men who talk reverently about the beauties of credit and the sacredness of contracts should reflect that the debtors are a larger family than the lender family and that the borrowers are better spenders than the lenders. The champions of prosperity by inflation forget that the consumer and not the investor is the keystone of our trade structure.

CHAPTER III

INVESTMENT AND COMPOUND INTEREST

FINANCE is a way of making money for bankers and not for investors. It is a series of mechanisms, many of which are necessary for facilitating the processes of production and exchange under the capitalistic system. The principal function of finance is to transmit savings from the savers of capital to the users of capital in production. The stock exchange, or securities markets, quite as much as a savings bank, should be thought of as a depository of savings. A deposit is made by the purchase of a security, and a withdrawal is effected by the sale of a security. There is, of course, somewhat less certainty as to the amount a depositor in the stock exchange will be able to draw out than there is in the case of a deposit in a savings institution. It must be remembered, however, that banks fail and that they never pay more than principal plus a small interest rate. Securities show a larger ratio of losses, but they often pay high dividends and appreciate in value several hundred per cent.

Investors, as a class, can receive for the use of their savings only some part of the fruits of production, in the form of rent, interest, dividends or profits. Investors cannot make one cent more than this compensation by trading with each other in the various forms of property on which their return is earned and paid by other people. The more investors trade with each other, the more they lose in trading expenses to the bankers and brokers. The income of investors can be augmented only by increased production by others, or by investors wresting from society, not from each other, a higher compensation for the use of capital, or a larger slice of the national income. The evil of credit as an institution is that it seeks to make society pay lenders for losses or mistakes, instead of assessing the costs promptly and evenly against all owners of capital.

As all investment selection is gambling, the only real science of investment selection must be based on actuarial or mathematical principles. A science is a body of knowledge and not an art of guessing which is practiced by people who call themselves experts or investment counselors. An investment science must have the following general characteristics: First, it does not seek to make profits or avoid losses, either for individuals or for the community of investors. Making profits and avoiding losses must be the business of those who manage capital in production or service. The investor buys a participation in their ventures. He cannot run their business for them.

Second, a scientific investment policy aims to give as close an approximation of the average return on all invested capital, whatever that return may be, as is attainable with the amount of money to be invested and the facilities enjoyed for its placement. In this country that return has averaged around 3 per cent over the long run.

Third, the science can be practiced by any number of investors and for any amount of invested capital, not just by so-called experts. The larger the amount to which the science is applied, the more nearly accurate will be the results obtained. One hundred per cent accuracy will be obtainable only if the science is applied to 100 per cent of the invested capital.

Fourth, the science aims at an utter lack of judgment in investment selection. It could attain a high degree of scientific injudiciousness, however, only with large amounts. When applied to small sums, the science would have to be blended with a large percentage of error, that is to say, judgment.

Fifth, the science recognizes that individual, judicious selection can never shape economic events, inasmuch as one selection judiciously made will be offset by another similarly made in a contradictory sense. Investment selections determine events only when a large number of them are alike. Such behavior, however, is really injudicious, being a mass response to some directing will or force. Investors do not select investments. Investments select investors.

As the best way to develop the ideas summarized above is

to show what scientific investment is not, further discussion of the subject is left for the next chapter on gambling in investments. The refutation of the fallacies of security trading for profit, or of the doctrine of the investment counselors, offers the best exposition of the principles of scientific diversification of risks.

The remainder of this chapter will be devoted to the discussion of compound interest. The investor is by definition the person who merely owns and does not, like Mr. Ford, manage income producing property. An investor may also be a manager, but investing and managing should be kept separate in one's thinking. The investment pseudo-scientists and the investment trusts have confounded the two functions.

Compound interest and not shrewd practice of the art of picking winners has been the principle which has explained the growth of all large fortunes accumulated merely by owning property and not managing production. Most of the large fortunes that have been passed down through two or more generations have consisted of land. Sometimes the property may be a share of an industry, in which case, usually, the owning heirs do not go on managing the property.

The one way to assure opulence for one's descendants in perpetuity is, first, to be lucky enough to select real property in the right place, and, second, to be able to leave it in entail so that there can be no use of judgment in the administration of the estate. If judicious selection of investments can thus be eliminated and the first guess be lucky, compound interest in land value appreciation will make the fortune grow as it has done in the Astor, Wendel, Girard and other large landed estates. It is largely for this reason that American law does not allow land to be left in entail for more than one generation and twenty-one years thereafter. Sometimes, of course, the heirs are wise enough not to be judicious and sell.

The sure way to make an estate gradually shrink to nothing is to leave it in the form of a list of investments to be judiciously managed by a bank or trust company trustee. As

Professor Dewing says,[1] "Only a few trusts administered by lawyer trustees were studied. These all showed a depreciation in principal, but not as pronounced as in the case of the trusts under administration by trust companies." It is a pity that the trust companies do not conduct a nationwide research in all banker-trustee administrations of estates over a fifty-year period and publish the results. What banker management of 3 billion dollars of investment funds can accomplish in ten years may be seen in the record of the American investment trusts, discussed in a later chapter.

Compound interest is the only investment principle of significance to an investor, once he has secured the best diversification of risks obtainable with his capital. Compound interest involves many features which should be clearly understood. For instance, no great number of large sums can grow progressively by compound interest over any long period. The selection of the right investments to grow in this way must always be a matter of luck. There can be no science of picking winners at anything. These features are susceptible of historical and mathematical demonstration.

Had these limitations been understood by everyone as well as most of the axioms of the first five books of geometry, by no means a subject of vulgar interest, the follies of the late bull market could never have happened. People play against Monte Carlo, but they do not cause an expansion of the volume of bank credit in order to do so.

The best preface to any discussion of compound interest is to say that if one cent had been invested in the year one at 6 per cent and compounded semi-annually thereafter, it would today represent an amount equal to several hundred million terrestrial globes of pure gold. Needless to say, the accumulation could not have proceeded beyond a few hundred millions of dollars, even assuming no political interference with the freedom of contract. The process would have slowed down as soon as the yearly income to be reinvested grew large, the reason being that interest rates would have declined in measure

[1] *Financial Policy of Corporations*, page 1204.

as the income increased until, finally, they would have fallen to zero. The fund, as it attained great size, would gradually have made its owner the proprietor of most of the earth. He could not, therefore, have found sufficient borrowers to pay him interest for all his income. The elements of this difficulty are present in the existing world debt problems.[2]

[2] The compound interest argument of this book may be reduced to the following two syllogisms:

FIRST SYLLOGISM:

Major premise: No quantity can increase by compound interest and remain within finite bounds.

Minor premise: The quantity of economic goods in the world cannot increase by such progression.

Conclusion: Therefore, the total volume of outstanding credit cannot expand for any length of time by compound interest.

SECOND SYLLOGISM:

Major premise: Granted that lenders will reinvest a part, however small, of interest income, over and above current losses on loaned principal, there are just two ways in which to stop the growth to infinity of lender's credits and the purchasing power the corresponding interest income constitutes. These two ways are: First way,—the decline of the interest rate to near zero; Second way,—the periodical cancellation of a large part of the total volume of credit in a major depression such as is now in course. In the second way the difficulty, thus far, has been met satisfactorily, that is to say, satisfactorily for the operation of credit, though not for the comfort of mankind. Only in one of these two ways can the total volume of credit or debt, two interchangeable words, be kept in a workable relation with the total volume of economic goods. There would, of course, be absolutely no sense to credit if a mechanism existed to cancel each year whatever part of interest income lenders might save and invest over and above the amount that might be needed to replace their losses on principal during the year. Credit would be equally senseless if a mechanism operated to keep the volume of credit in a fixed ratio to the increasing or decreasing volume of goods. Such a mechanism would, for instance, automatically bar war loans which increase the volume of credit in ratio with the volume of goods destroyed. The Bank of England was founded to finance a war.

Minor premise: The present financial organization of society is such that a progressive decline of the interest rate to near zero would entail consequences which seem humanly unendurable. The declining interest rate would paralyze economic activity long before a zero interest rate was approximated.

Conclusion: Therefore, periodical credit collapses, such as we now have in course, are a rigorous necessity for a prolonged use of credit.

MORAL: The way to avoid major depressions would be to avoid undue credit expansion. But, given the legal right and innate disposition of wealthy lenders to save and invest some part of net interest income, the only way to avoid excessive credit expansion is to avoid large scale credit uses. The avoidance of credit uses would be entirely feasible under modern capitalism. Pay as you go and grow would be the motto. It would be perfectly simple to work out adequate mechanisms to make proprietor's capital replace lender's capital, at least to such an extent that lender's capital would be negligible in its effects on the business

The illustration may seem too absurd to merit discussion, yet such a *reductio ad absurdum* is needed in these days of absurd financial doctrines and mad practices in order to bring out certain important and persistently ignored ideas. Analysis of the absurdity of compound interest over a long period shows why large sums cannot go on compounding indefinitely. It shows further why a concentration of wealth in the hands of a few people, yielding them an income in excess of their consumptive needs, constitutes a mathematical as well as an economic absurdity, which reason abhors and events conspire

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cycle. Then the market value of proprietor's rights could never get far out of line with the market value of the existing stock of goods. I.O.U.'s on which a cipher more or less means little at the time, are the main factors disturbing price stability. Exchanges of things and labor for things and labor present no price difficulties. Exchanges of things and labor for rights to future payments of money are susceptible of incalculable abuses and absurdities. The rights get out of relation with the realities. Under an ideal capitalistic economy an investor seeking to buy an income would realize that he was only buying either (1) a right to the future exchange value of the products resulting from the use to be made of his capital; or (2) a right to the enjoyment and fruits of a given thing like land, a machine or a horse. The rights of property must, if they are to be maintained, show respect for economic realities. As it is, lenders look mainly to fictitious factors for security of future income, as when they buy war bonds or bonds to finance reparations payments. According to the computation of Dr. Max Winkler, (Bulletin of the Foreign Policy Association January, 1932) there were in default on January 1, 1932 20 billion dollars of Government bonds. And this figure did not include defaults of the 19th century, interest defaulted or the tens of billions of war debts which have been extinguished by legal devaluation of the currency as has occurred in practically all the belligerent countries, Great Britain now being about to join the number.

A proprietor's right, other than a lender's right or claim, commands certain specific things in being or to be brought into being. (A lender, of course, is a proprietor owning a piece of property called a right of action.) The specific money income to which the non-lending proprietor buys a right is the money income that is actually realized. A lender's right of action, on the other hand, commands a fixed quantity of money, regardless of any limitations of reality such as the future purchasing power of the promised quantity of money, or the debtor's economic capacity. For a short time these fixed money claims of lenders are compounded with utter indifference to their relation to any economic reality. In war time, money rights or claims are issued by the billion to lenders against property which is forthwith destroyed. These money rights subsequently go on compounding into perfectly fantastic structures of national debt. All of this is sheer madness. Property rights over things in existence or over future income in things, if, when, and as such income may be realized, make some sense. Rights to future payments of money, which is to say, to future deliveries of goods of indeterminate quantity based on goods destroyed makes nonsense. It also makes the present world situation.

to terminate. The rich, as a class, who try to grow richer by the play of compound interest present exactly the same phenomena as the one cent after a few hundred years of compounding.

The point has greater relevance than ever in view of the steady concentration of wealth in America in fewer and fewer hands since the war and in view of the trend towards trust funds, foundations, life estates and other accumulations of wealth calling for yearly reinvestment of income. The fact is that these trustees and managers of other people's money have literally got to lose a large part of it. In so doing, unfortunately, they must make thousands of small savers of wealth lose their savings in the same general proportion.

The somewhat crazy process of compound interest, like many other anomalies of capitalism, is all right, or at least tolerable, provided it be conducted with moderation. It is when a government is directed by men sufficiently devoid of a sense of humor as to exact a debt settlement running over 64 years and involving total payments in excess of 22 billion dollars, or when millionaires grow too numerous, that capitalistic processes break down.

Compound interest can work satisfactorily, if used during one lifetime or even two lifetimes to build up a modest competence to support a man in his old age and to be squandered by his widow and children in their lifetimes. Capitalism can even stand a few glaring examples of the growth of a large fortune over a century in the hands of a succession of heirs who are wise enough not to use investment judgment. But these examples must not be overnumerous. Capitalism implies moderation and balance.

No serious compound interest difficulty is created, however, by large fortunes, the current money income of which is entirely consumed each year by the beneficiaries. Capital losses, over a long period, will gradually extinguish such accumulations of wealth. Many good people, applying the logic just stated, rather naïvely imagine that the foreign investments of

the United States would constitute no problem if we received and consumed the income in goods.

The point overlooked by these people is that nations need activity rather more than they need goods. A modest amount of income on invested capital may serve quite pleasantly to endow a reasonable number of wealthy loafers. But endowed loafing by a nation has serious defects, the nature of which could best be explained by any one of America's six to eight millions of unemployed.

Within a nation, the endowment of a reasonable number of loafers with a comfortable income from invested capital is no great calamity, provided they loaf in a way to entertain agreeably the populace. Of course, if the people are not amused by such loafing, it has to be stopped. As long, however, as poor Americans and Englishmen derive extraordinary satisfaction from news of society doings, society in these countries should give the people what they want. Probably three hundred sixty-five days' reading of society chronicles, with occasional glimpses of the loafers, will afford more spiritual delight to the American or British masses than a one or two days' blow-out at Atlantic City or Blackpool with the money which might accrue to the poor were the income of the elegant loafers nationalized. Of course, the poor should be assured steady work, for hungry people do not find the rich amusing.

American philosophy in this respect is completely at loggerheads with sound social policy and leads to such grave economic disorders as are actually in course. The commercial aristocracy everywhere is, in varying degrees, governed by the same unwisdom. Either (1) the income of the rich must be confiscated by taxation or regulation of profits and wages, or (2) the rich must spend their full, unearned income in ways that agreeably amuse and employ the populace. There is no other way.

The crime of the rich is that of getting richer by compound interest. It is not that of having a good time, which the poor really want the rich to have. Loafing by the rich is a form

of vicarious enjoyment for the poor who cannot enjoy themselves as they would like!

The offspring of the rich should be trained for careers of graceful idleness like the descendants of European royalty, who invariably give a finished performance for those who like that sort of show. Artistic loafing is a career of high social service and should be taken as seriously by the loafers as it is by their public. Whenever the report is flashed around the world that the Prince of Wales has tumbled from his horse, millions of tender hearts beat faster. This is both a charming spiritual sensation and an economic commodity for the fabrication of which Mr. Macfadden and Lord Harmsworth have developed important publishing industries. But how can the news that President Coolidge's son has got a job on a railroad cause a flutter in any fair breast? Why, it probably cannot even make the trains run any faster.

Trends in our preparatory and finishing schools, as well as in our best universities, are beginning to show some recognition of the social requirements of the rich. Unfortunately, however, these institutions are mostly situated in the East, where wealthy youths are exposed to horrible traditions and examples of industry, thrift and drab living. A few wealthy young men, it is true, inspired by high ideals, creditably resist these bourgeois influences and emerge from our academic country clubs to play their proper rôle in society with distinction and charm. Most of these unfortunate adolescents, however, not having so much character, go to the Harvard Law or Business school and try forever afterwards to look and act like a stereotype of a successful money maker instead of behaving like a normal human being out to enjoy life.

Now, a successful business man doubtless has quite as good a right as a New York or Philadelphia politician to settle a life endowment on a relative. The endowed loafer related to the politician has, however, to perform occasionally some nominal service in order to stay on the city payroll. The loafer endowed by the successful money maker should render the social service of not taking a job from the unemployed and of

loafing gracefully. But the successful money maker should not have the right to create funds to be administered in a way to disturb the economic equilibrium of society.

Endowments for religious, educational, medical and other cultural purposes usually provide for the expenditure of their full income and thus create no serious compound interest problem. From the point of view of any social philosophy suited to the modern mind, it would seem clear that all such endowments should be suppressed. No man should have the right to use economic pressure to foist on the present generation and still less on the future generation his ideas or ideals. Each generation should determine the economic support to be given to all social institutions and services. Sufficient unto the day are the philanthropies thereof.

This position is not doctrinary after the manner of the socialists, but pragmatic. For if all rich investors save and reinvest a large part of their income from capital, as they have been doing, with the result of getting richer until the periodical blow-ups, these policies must inevitably tend to cause unbalanced investment, overproduction of certain things and the culminating crisis.

These observations will, no doubt, evoke an expression of that fear which has always seemed to haunt the dreams of classical economists—the fear of insufficient saving. Now it would be difficult to cite in all the history of mankind the case of a single tribe or nation that became extinct because its members did not save enough, and there have been some decidedly meager savers. It would, on the other hand, be extremely easy to establish a connection between the extinction of many a people and their growing accumulation of wealth. It would also be hard to prove that any people's happiness had increased or decreased with the size of its wealth.

The fact is that the man who threatens insufficient saving is usually worried about some particular use of savings which lies close to his heart or pocketbook. It is invariably forgotten that any spending or consuming policy under the capitalistic or price system will automatically call forth the savings necessary

to keep itself going, granted any but the most unusual circumstances. Consumption is self-sustaining, except when financed on credit. Saving practiced for saving's sake is self-destroying.

On the point of insufficient saving, then, the contention is simply that saving adequate for the needs of society will best be assured without the collaboration of the man who has no need to save. Adequate saving is assured by the following factors: first, and foremost, the man of small but sufficient earned income who wishes to provide a competence for his old age or dependents (He is the backbone of all useful saving under capitalism); second, those who suddenly acquire great wealth, whether due to their own skill, or whether through a sheer windfall (They are almost certain to save a large part of their newly gotten wealth); third, corporate policy in withholding dividends and expanding (where demand dictates) plant out of earnings (In this way over half the capital that goes into industrial production is already being saved); fourth, the state, which, in the construction of new public works out of taxation, is saving over 3 per cent of the national income each year.

A great deal of investment each year—in fact, most of it—should not be thought of as saving from the point of view of society, but merely as replacement of wear and tear and obsolescence. A well-run government, city, railroad, public utility or corporation, which is not exploiting a wasting asset, should make automatically, out of taxation or earnings, all requisite capital replacements. In this way most of the community's necessary saving may be done without any sale of new investment securities. (Many American states and cities are now on the verge of bankruptcy because of continuous bond issues for desirable public works which should have been paid for out of taxation as built. Ninety per cent of all public borrowing is mathematically unsound.)

The argument is not that there has been oversaving, but that there has been an unwise or anti-social use of saving. If the Report of the Wickersham Committee and the recent earnings statements of most American corporations have any meaning,

it is that too little of the nation's savings has gone into up-to-date prisons and too much into now idle factories. This book holds—and it should not be imputed to it for socialism—that it would have been preferable to confiscate from the rich by taxation, for the construction of sanitary homes for the poor or æsthetic approaches to American cities and towns, the vast sums the rich invested unwisely in factories now idle. The rich would be little poorer today and a great many people would be much happier for such a use of the savings of the rich investor. There are other ways of confiscation than taxation; and there are other ways of saving than private investment. The investors are the victims of confiscation by Wall Street, and the people are the victims of underinvestment in the right sorts of properties.

The need is for greater moderation in the accumulation of large fortunes. This means the discouragement of saving which is not dictated by obvious needs. The man who saves for his old age has a reason. The man, like Mr. Ford, who saves because he cannot well help it, is no problem. Mr. Ford's savings take a form which is likely to prove socially useful.

Had Mr. Ford sold his business before the crash for a billion dollars, as well he might, he would not only have lost most of it in the investment selections he would have made, all of which would have been unimportant, but he would have deprived society of a good management of a great industry. The fact that Mr. Ford owns a billion dollar industry is not so important. The fact that he runs it well is important. The fact that he does not racketeer with a billion dollars' worth of securities is most important. A billion dollar fortune mobilized in an investment-for-profit campaign in the investment markets would be a social evil of the first magnitude. Mr. Ford is, doubtless, the last man in America to contemplate any such policy.

The growth of large fortunes from unearned income could be satisfactorily checked by progressive surtaxes. The result would be less saving by the rich and more saving by the poor and by the state. This might be distasteful to the rich, but it

would not be an assault on capitalism. Small capitalists are just as good capitalists as big ones. And, who knows? It might be a good thing for capitalism to have rather more small capitalists and fewer multimillionaires and unemployed.

In conclusion, the investor's investment problem is only to obtain the average return on capital; and the major problem of society in connection with investment is to prevent its use in ways which disturb economic stability. Excessive profiteering by bankers in securities traffic should be discouraged. The growth of large fortunes by compound interest, or unearned income, being an intolerable interference with economic stability, should be checked by appropriate surtaxes. The investment problem is seen to be not one of insuring a sufficiency of investment capital, but one of exercising social restraint and guidance over the investment processes.

CHAPTER IV

JUDICIOUS INVESTMENT SELECTION OR GAMBLING

ANY attempt to beat the average return on capital by the act of selecting investments is a pure gamble, subject to certain well-proved mathematical laws. Most players must either beat the average or be beaten by it. This is a matter of mathematical necessity in a game at which almost no one seeks the average and at which nearly everyone aims at maximum profits or highest return. Judicious investment selection seeks to avert losses. Scientific investment seeks to average losses. There can be no science of picking winners or avoiding losers.

Nothing is easier, looking backwards, than to show how *an* investor could have picked winners and avoided losers. He would have sold New Haven stock when it was the favorite investment for widows and orphans and the protégé of New York's premier banking house. He would have bought Bell Telephone stock after the president of the Western Union Telegraph Company and other competent authorities had pronounced it an impractical toy. In 1914 he would have sold German Government bonds for Krupp common stock. He would have switched from Russian Government bonds recommended by the best French bankers to United States Steel stock barred from the Paris Bourse. In 1920, he would have disagreed with New York bankers and would have sold Cuban sugar stocks to buy General Motors at $12. Twenty years from now investment counselors, if they still have a following, will be explaining what the judicious investor did in 1932.

If human memory ran forward as well as backward, economic losses could be averted, but not by decisions of investors. The losses would be averted by the people who employ capital. If they thought it would be more fun having losses, even though they were foreseen, then investors would have to bear

their share of such losses, exactly as they do at present, though it would doubtless be necessary to work out an equitable system of distributing the losses. But it is not necessary to foresee future losses in order to make an equitable distribution of their incidence. Lloyds have been doing this successfully for over two centuries, though they have never employed forecasters to tell them what ships were going to sink. The answer to the investment counselor is to tell him that, if he could foresee the future, he could not render investors any useful service.

Systems which purport to enable investors to avert or minimize losses are as dishonest as systems to beat Monte Carlo. The only honest advice to a player at Monte Carlo is to state the mathematical chances on each play. This information no one but a fool would pay for and no one but a rascal would try to sell. In investment matters, there is no valid basis for estimating the chances of profit and loss on any given investment. The best investment advice for a lawyer with $1,000 to invest might be to tell him to take a three months' course in steamfitting. We can predict the future behavior of the roulette wheel but not of the economic factors controlling investments. Science cannot show an investor how to avoid losses. It can assist him in averaging losses.

If there were a system for averting losses, there would be no losses. Insurance companies furnish the best proof of the proposition involved in this paragraph. An insurance company can reduce its losses only by reducing the volume of its business and profits. It makes its profit out of bearing losses, not avoiding them. If there were no losses, there would be no insurance. If there were fewer losses, insurance premiums and profits would decline correspondingly. If there were no losses in enterprise, capital would soon become so redundant that interest rates would sink to practically zero. The reduction of losses cannot help investors or insurance companies, though it might be beneficial to society. The term "loss," it must be remembered, is only a subjective appreciation of certain types of expenditure. Investment is consumption.

The fact is that there is practically nothing investors can do

in the complex economic situation of today to modify the return they receive on their invested capital. The return is, of course, subject to modification, but not by reason of any exercise of judgment in the making of investment decisions. To avid readers of economic statistics it may be depressing to learn that, over the long run, the volume of economic production is utterly inconsequential to the investor. No less unimportant to him are the phenomena of prosperity and depression. The only economic developments of real importance to the investor are those which modify the percentage of the national income received by capitalists for the use of capital. These developments are almost entirely outside the investor's control as an investor.

If production increases and demand keeps ahead of it, obviously, the income of investors will, for the time being, be greatly increased. But, this development is never due to investment decisions. Investment decisions do not consciously cause wars, gold rushes or the settlement of new continents, nor do they cause to germinate new ideas in the brains of inventors. Peter the Hermit, the Crusades, the Renaissance and the explorations of the Spanish and Portuguese were not investment phenomena.

The investor's joy over prosperity is wholly infantile. Eventually, production outruns demand in the profitable lines of enterprise. The return to investors declines to nearly nothing. New savings of the investing class command a lower return. Losses are enormous. The long run result is that the average return over the years is brought down to below 3 per cent,—that is, in the past.

The net return on invested capital cannot in the long run exceed the amount required for new investment plus the amount consumed by investors. These two quantities are naturally flexible. The big point that is overlooked is that their expansion or contraction is little affected by investment decisions. Even in the amount of their personal expenditures, the decisions of investors are not governed to any significant extent by purely investment considerations. For instance, the

reason Mr. Mellon does not consume as much on living expenses as the Gaekwar of Baroda or King Solomon has nothing in the world to do with money rates or investment policies. White elephants could not be kept clean in Pittsburgh and the best people do not keep a thousand wives these days. Investors do not spend more and save less because the return on capital is lower and vice versa. Their personal expenditures tend to decline with their income.

As for the amount required for new investment, this factor is determined by social standards and cultural trends. Any significant change is the result of a fortuitous play of innumerable factors which investors usually do not understand, much less consciously influence.

It seems altogether likely, for instance, that in the present state of social institutions and attitudes, if investors were, as a class, to reduce considerably the percentage of income they save for fresh investment and spend that much more on personal consumption, they would not thereby raise interest rates or obtain a materially higher return for such savings as they might make. The law of supply and demand would not work in this case as might be expected for the simple reason that the government and corporate directorates would make up the deficiency in private saving by new construction paid for by taxation and corporate earnings withheld from stockholders.

The point emphasized is that investors are both unimportant and helpless. They own a stake in the economic unit called the United States, but there is nothing they can do about it, except worry and lose money uselessly. They are not running the show. Investors are a herd of sheep led by their bankers, politicians, advertisers, labor union leaders, organized minority leaders, in fact, by almost everyone except a representative of the investing class. The banker sells to the investor. No one can sell to a man and at the same time represent his interests, except in advertising fiction. The prosperity of the economic unit, America, in which the investor owns a stake depends on others. This being true, the investor who studies economic data and worries his head about their meaning is

serving no useful purpose except to make business for stomach and nerve specialists.

In a penetrating article entitled "The Separation of Ownership and Control in American Industry,"[1] Mr. Gardiner Means analyzes 200 of the largest corporations having combined assets (when the study was made) of over 81 billion dollars. Measured in percentages of assets, control is exercised by owners in 6 per cent of these investments; 14 per cent are under direct minority control; 22 per cent are controlled by a minority through some legal device, such as a holding company or voting trust; and 58 per cent are under control by a management which is self-perpetuating and, practically speaking, immune from control by owners.

For instance, the Van Sweringens own less than 1 per cent of the Chesapeake and Ohio Railroad, yet they control it. In 1929, H. L. Doherty and Company, with the ownership of stock of a par value of one million dollars controlled one billion of assets in Cities Service Corporation. In 1929 a group having an investment of one million dollars in Standard Gas and Electric stock at par value were able to cast 41 per cent of the votes outstanding and control a billion dollars of assets. The largest stockowner of the Pennsylvania Railroad or the American Telephone and Telegraph Company (the latter has half a million shareholders), owning less than 2 per cent of the company's stock, can influence the running of his company far more through an anonymous letter to the *New York Times* than by any practicable action he can take as a stockholder. It is assumed that a hundred thousand dollar lawsuit is not practicable. Even if a stockholder wins a legal decision against the management of his company, the decision is usually worthless to him. The management controls financing facilities and the dissatisfied stockholders do not. The only suits of stockholders against management that have any practical significance are those brought by one strong financial group against another group in control of management in the company. The

[1] *Quarterly Journal of Economics*, November, 1931.

investor is an onlooker in these battles, much as the citizen is in great wars.

The medieval king by divine right admitted no responsibility to man but recognized full responsibility to God. The self-perpetuating directorate of a billion dollar corporation acts under no real sense of responsibility to God or man. In fact, government itself, in America, is conducted with a view to pleasing these financial rulers. As for public opinion, they have experts to mold it to their liking, through the newspapers, radio and universities.

The property of a minor or an idiot is administered by an officer of the court. The court holds this administrator to certain standards of decent conduct, without necessity for the fighting of a half million dollar lawsuit on behalf of the ward of the court. For instance, a court officer, guardian or trustee, may not profiteer from speculation with the assets of his ward. Practically speaking, investors have no more to say about the management of their corporate property than minors and idiots and they are less protected. The status of the ward has been realistically recognized by the law. The investor is nobody's ward and everybody's fair game. As practices among bankers and corporate managements tend to be fairly uniform, the investor has no choice.

Investors have been cruelly misled by tipster propaganda emanating from the most respectable sources to draw fallacious parallels between the investor, *qua* investor, and the business manager, *qua* manager. Investors cannot shift invested capital as manufacturers shift productive operations. Capital is largely non-transferable. In most cases, when it is sunk, it is sunk for good. Only the titles to capital can be freely transferred. For instance, it became evident some fifteeen years ago that cotton was in for a decline and that silk and silk rayon were in for a boom. Such changes impose the abandonment of a great deal of plant and the wiping out of capital values based on expected earnings. But it is the manager of industry who makes the decisions, and the investor who bears the losses and puts up the new money needed. The notion of swarms of

American investors fluttering over industry like so many bees among the flowers, guided hither and yon by shrewd investment advisers to spots where the nectar is sweetest, would be grotesque if so many apparently intelligent people did not entertain it.

The only scientific advice to investors as to what to do in anticipation of new trends in industry must be similar to the sea captain's reply to the nervous old lady who wanted to know what to do in case of seasickness. Investors will always do the only thing there is for them to do about changes in industry. They will bear the losses and invest out of fresh savings in the new enterprises. For this no expert advice will be needed.

Business forecasting is a new racket about which a great deal of heavy writing and light thinking has been done. There may be something to be said for the view that the larger the basis of research data and the more technical the methods employed, the greater the chances are that guesses about the future will be accurate and cover all important developments. It is, however, the present contention that the emotional bias and personal interest of forecasters are far more influential on their guesses than the quantity or quality of their information or guessing methods.

Professor Garfield V. Cox is the author of two competent studies of business forecasting, the last one covering the performance of six forecasting services, one of which is conducted by an institution of higher training in the art of business. His most useful conclusion on this subject is probably the statement that forecasting is "not scientific in any strict sense of the term."

Professor Cox nowhere undertakes to determine whether the forecasts discussed could have been used by investors or producers, as a whole, to make money. The services of forecasting which he studied are graded for accuracy in predictions and the foresight to predict important changes that occurred. The most important fact about his grading is that the scores for foreseeing important changes were 50 per cent lower during the period of November, 1928, to October, 1929, than they

had been during the ten preceding years. It is easy to make a good score on guessing during a long trend in one direction.

Now, forecasts have two leading qualities: they are usually cryptic and susceptible of great latitude of interpretation, and they are limited to fairly obvious predictions. Professor Cox's scores indicate that he found that the services he studied were right a little more than half the time on their guesses. If all the forecasts contained in pre-war memoirs, correspondence and political writings with regard to the events of the next five years after they were uttered were checked against events, it would probably be found that a correspondingly high percentage of accuracy characterized these guesses. It is no great trick to make impressive and obvious forecasts about the near future and have 60 to 70 per cent of them come true. The economic forecasters practice tricks long in successful use by shrewd gipsy fortune tellers who can usually guess a number of obvious facts about a consultant and the consultant's immediate future.

Thus far, economic forecasters have proved that there are just two ways of making money out of guesses about the economic future: The first way is to sell the guesses to subscribers. The second way is the investment trust method, to be discussed later, namely, the method of securing funds for speculation on a "heads we win, tails you lose" basis. The commissions of operation assure a bread and butter business to these gamblers with other people's money, no matter how much they lose.

The important fact about business forecasting, whether it goes forth bearing the seal of truth of a great university or whether it is hawked on the sidewalks as a ten cent tabloid, is that the customers of the guessers have guessed and lost. When this fact has been stated, there remains little more of a scientific nature worth saying about investment forecasting or advice as to the future.

It must be remembered that every investment, whether a liberty bond or a mining stock, is as much a chance as a right. A correct prediction of the future value of that chance adds

nothing to such value. The correct prediction merely puts the present market price out of line with the future value of the chance. All such predictions cannot be right. By enhancing narket prices through unscientific guesses, tipsters, whether operating in universities or on the curb, only act as a disturbing nfluence on prices. Why disturb prices through unscientific guesses, which can never create any utility?

The only forecast of value to the individual investor is a guess which happens to be right and does not happen to be nade by a large number of other guessers. Needless to say, uch guesses must be rare. The worst of the investment selecion fallacy, however, is that it proves its soundness and conutes its critics during long periods while the fallacy comnands general belief and while the believers can obtain credit o support their belief.

In the rise of Radio stock from $40 to over $500 in less than wo years, or in the rise of an aviation stock, sponsored by one of New York's largest banks, from $70 to $160 within a nonth, we saw how investment foresight served investors. Both tocks are selling today at less than one-tenth of those inflated rices.

Americans are unusually easy marks for speculation because of their veneration for facts, their contempt for ideas and their nvincible aversion to thinking. Now facts can always be used o prove the soundness of speculative optimism, while only deas and thinking can prove the unreality of such values. No ection of a daily newspaper contains more facts or facts of reater exactitude than the financial page. A mistaken stock uotation is almost unknown. Yet no section of a newspaper ontains more falsehood and deception as to realities.

We are mentally too immature and deficient in philosophy o comprehend that facts are only appearances. Facts are purely ubjective. And no type of fact is more subjective than a market uotation. In less philosophical terms, speculation creates its acts to justify its beliefs.

Any person who on March 30, 1926, had evenly distributed bout $110,000 in the purchase of 50 different common stocks

corresponding to the representative list kept by the *New York Times*, and had subsequently held the securities called for by this list, would have, since that date, seen the following changes in his wealth:

Low for the year		*High for the year*	
March 30, 1926	$109,630	December 20, 1926	$142,350
January 27, 1927	135,430	October 4, 1927	185,470
February 20, 1928	173,130	December 31, 1928	231,450
November 13, 1929	164,430	September 19, 1929	311,900
November 12, 1930	147,870	April 10, 1930	245,600
December 17, 1931	67,670	February 24, 1931	173,070

The fact about these facts is that up to September 19, 1929, the optimist was always right, if he used no judgment and selected a diversified list of securities. Indeed, it would have been a most exceptional use of judgment which could have picked losers during that period.

The experts, however, recognized that prices of securities might have their downs as well as their ups, but they had a system to exploit with profit both the ups and the downs. This system will be briefly explained, by way of doing full justice to the doctrine of judicious investment.

On the uptrend judicious investors would buy common stocks and hold them for a time, selling at some point before the top of the market was reached. This would, of course, yield a handsome profit. They would then buy bonds, which, according to the theory, would be depressed in a rising stock market. As a matter of fact, bonds did begin to slump before the peak of the stock market was reached. Mr. Mellon, who is not ordinarily lavish with investment wisdom, is reported during the bull market to have vouchsafed the opinion that bonds were then a good buy. At that time the market price of the *New York Times* list of 40 domestic bonds was 90. By the end of 1931, the same list stood at 64. All of which merely proves that Mr. Mellon is not as good an investment adviser as is hindsight.

Continuing the exposition of the system for beating the market, it may be said that the next step is to await the inevitable recession of stock prices. Then bonds would rise in

value. (They have not done so, of course.) The investors of good judgment would wait for a time until the liquidation of common stocks had run its course. Prices would once more come into line with values. The judicious investors would then sell their bonds at a modest profit and cautiously buy cheap common stock for the inevitable upturn. In this judicious manner, wise investors would roller-coast forever by gravity on the curves of the business cycle.

But there are two main defects in this roller-coaster investment policy. In the first place, no one has ever been able to tell the length of a boom or a depression until it was over. In the second place, if any large group of investors act on any plan to beat the game, their combined actions conspire most effectively to defeat their purpose. For these reasons all investment systems must be fallacious and unworkable.

Let us suppose that any considerable number of judicious investors were to practice some such system as that just described. At some time during the early stages of a rising stock market they would sell their bonds, mortgages and real estate in order to obtain cash for the purchase of common stocks. This action would naturally depress the prices of the properties they sold and thus seriously impair their capital at the start. Were they to try to borrow, they would be forced to pay penalty interest rates. The costs of obtaining funds for purchases in a rising stock market, however, would not, at the time, seem of any consequence. Demand for common stocks would further inflate prices. After a time paper profits would be enormous as other suckers, presumably the injudicious, would flock into the market to see themselves grow richer every day by the mere mechanics of the stock ticker.

The breakdown of the system would come just as soon as this large group of judicious investors started to realize their profits, assuming, of course, the injudicious did not beat them to it. If the judicious investors were merely to switch their investments in the same market, such action would constitute no realization of profits, except for income tax purposes, and

would not adversely affect the market. On the contrary, the more buying and selling there is, the better a bull market flourishes. The only acts that ever deflate a bull market are large withdrawals of money from the market by investors. Investors withdraw money from a market by the simple act of selling for cash securities traded in on that market and subsequently placing the cash so received in investments other than securities of that market.

When these or any other number of investors began to cash in their chips and go home, only those at the head of the line would ever be able to collect at profit-yielding prices. The game would break up in great disorder, while the President of the nation and other distinguished citizens would make frantic efforts to inspire confidence in values which never existed except in badly deranged imaginations.

European investors in the American stock market undoubtedly precipitated the first break in October, 1929, through the quiet withdrawal of funds. This realization on American investments was prompted by the growing uncertainty of the European situation and by reflection on the disclosures of the Hatry financial scandal in England in August, 1929.

Here it should be remarked that the main difference between the stock exchange and Monte Carlo is that the players in Wall Street draw dividends and interest on the stakes they keep in play, while at a casino the players only play and pay. This is why gambling on a roulette wheel develops few insane ideas.

One of the reasons why a bull market has to collapse is the item of mounting expenses caused by speculative trading. The costs of keeping up the illusion become too heavy for the speculative traders on credit. Notwithstanding the publicly expressed opinion of President Coolidge in 1928, brokers' loans were too high, and not only brokers' loans, but every other form of credit use was being overdone. (There was a time in American history when the President of the Republic would not have deemed it proper to issue tipster statements about the stock market.) The players on the stock market were

paying interest on 6 to 8 billion dollars of security loans merely to furnish the country with a delusion. Now, while players in a casino receive no interest on the money they have in play, they usually do not borrow that money. Moreover, the amounts in play are relatively small in reference to the liquid funds of the community and the needs of commerce. Stock market gambling, on the other hand, withdraws billions of dollars from trade and stagnates these funds in a speculative pool of credit.

When speculation is rampant it does not matter whether the money is borrowed on stocks or on real estate mortgages. All qualitative distinctions in credit are idle and deceptive. It is only quantity that counts. All uses of credit have one quality that is important: they create purchasing power. The most significant facts about the bull market were greatly increased gambling, greatly increased debt, and a normal increase in physical production. The increase of physical production or real income—the only source from which investors can derive a return—has been fairly constant over the past fifty years, as Carl Snyder's figures show, at the rate of about 4 per cent a year in this country and 3 per cent abroad. Our subsidized economists established a connection between stock market gambling and production.

At the time, the mounting costs of speculative trading and the growing volume of debt seemed insignificant as compared with the 80 billion dollars of increased wealth they were creating for the nation. This was doubtless why President Coolidge pronounced a benediction over the increase in brokers' loans. The fact that call money rates went to 20 per cent was not influential on the course of speculation, as long as new players kept flocking in and none of the old players cashed in their chips. The president of New York's largest bank merely made a public gesture of throwing several millions of his bank's money into the call money market to "inspire confidence," and courageous words were spoken from Washington.

In this connection the point is made that importance does not attach to *where* or *how* speculators or investors—two

synonyms—got the money to put into the market, but to *why* and *how* they got the *idea* of putting so much money in and taking none out. To criticize the legitimate lending of money on call or to say that too much use was being made of credit does not strike at the root of the evil.

The proper subject of attack is the fallacy that money can be made by investment selection or stock trading. Attack on this body of false doctrine inevitably strikes home to its teachers in high places in our political, financial and academic life. It was they who led the investor to believe that he could obtain more than the average return on capital. It was they who taught that gambling was in itself productive and not merely a necessary evil of capitalism, to be kept down as much as possible.

CHAPTER V

THE BANKER'S FUNCTIONS

THE modern American banker's most important functions are those of a seller of investments and credit and of a manager of industry.[1] The theme of this chapter is that the banker sells on a let-the-buyer-beware basis and does not exercise his managerial powers in trust for the benefit of investors or of the public. The seller-buyer aspect of the banking function will receive more attention largely because it is the easier subject to discuss. Modern corporate mechanisms and ways are so varied and complex and both the law and judicial decisions are so far behind the times that any attempt to discuss this subject must involve the making and interpreting of law. No effort, therefore, will be made to do what it remains for the law to do: to give a realistic definition to the existing relations of the banker as manager, both to investors and to society. Our knowledge of these problems, however, is sufficient to warrant considerable criticism of things as they are happening.

With regard to the seller-buyer relationship, this chapter argues that, inasmuch as the banker is a seller, he interferes with a free market by acting as a trusted investment adviser, by the use of propaganda and by manipulating the market to favor the placement of his overpriced wares. In law and in fact the banker does not occupy the relation of a lawyer to a client or of a family physician to a patient, so far as the

[1] With regard to the banker's function as a recipient of deposits, the following quotations from H. D. Macleod's *Theory of Credit* (pages 585 and 606) state the law and economics of the case: "A banker is a trader who buys money and credits, or rights of action payable at a future time, by creating and issuing credits, debts or rights of action payable on demand." "A bank is merely a shop for the sale of credit."

A depositor buys an investment in the same legal and economic sense as the purchaser of a share of mining stock. The depositor gets his money back by selling a check on his bank and the shareholder by selling his share—if he can.

investor is concerned. Banking is a selling business—not a profession.

In support of the position here taken, no better evidence could be adduced than the testimony of Mr. Wiggin, Chairman of the Board of Directors of the Chase National Bank, America's largest bank, before the Sub-Committee of the Senate Manufacturer's Committee on October 30, 1931. The following extracts are quoted from the Associated Press report:

"Mr. La Follette, 'Do you feel the policy of investment banking institutions had any part in the excessive speculation that took place prior to the depression?'

"Mr. Wiggin, 'Of course, speculation was in the air, and there was a demand for investment securities. Bankers supplied that demand. I don't know who was to blame, the fellow wanting to buy or the fellow wanting to sell.'

"The witness and the Committee Chairman argued about the responsibility of bankers for the speculative boom and Senator La Follette finally asked if the profits bankers made had any influence on their conduct in floating issues of securities.

"Mr. Wiggin, 'Undoubtedly, the bankers did business at a profit. But no banker intends to offer securities that aren't going to be absorbed. I don't think you can justify holding bankers for the speculative craze. They were trying to supply what the customers wanted.'

"Questioned by Senator La Follette, Mr. Wiggin said he did not believe an economic council could have checked the excessive expansion which preceded the collapse of 1929.

"Mr. La Follette, 'Then you think the human capacity for suffering is unlimited?'

"Mr. Wiggin, smiling, 'I think so.'"

This book has already indicated concurrence with Mr. Wiggin's realistic view that the bankers are not legally responsible for what they sell. Let us pursue this idea. The banker must serve investors as seller or agent (brokerage service). Likewise, he must serve the producer as seller and buyer. The

banker supplies capital for production, by the sale of credit and the purchase of the producer's debts, usually in the form of securities or short term paper. The banker holds a part of these debts as investments purchased with banker credit supported by seven to ten per cent of cash. The banker tries to sell to investors as dearly as possible many debt instruments purchased from borrowers. In addition, of course, the banker renders a number of specialized services, like trust management, collections and execution of sundry commissions, the technical details of which have no great importance in this discussion.

Here it should be noted that the bankers who run the financial machinery of America from New York are not to be confused with the bank corporate entities of which many of them are directors or officers. These corporate entities are owned by the stockholders, but they are run by the bank directors and officers who, in no real sense, are controlled by the owners. The personality of the large New York bank is not that of its owners who cannot have a composite personality except in the fiction of the law. The large bank has, for practical purposes, a personality of flesh and blood. It is the man or two or three men who run the institution. If the bank is conducted by these few individuals with great unsoundness and even dishonesty, as was the $250,000,000 Bank of United States, whose president and vice-president are now serving jail sentences, the innocent and irresponsible owners find out about it in the newspaper accounts of the trial, after the state bank superintendent has closed the institution and the state's attorney has begun criminal prosecution.

It is important to remember that if the assets and operations of a bank are unsound, only the state or national bank examiners learn the facts and they never disclose them until the bank is closed. Bank owners are, therefore, only important in three respects: they buy stock, receive dividends, pay assessments when the bank fails. Bank management and state supervision are the two important factors in banking. Practically the only thing a stockholder can do about his bank is to try to sell his stock, and the only thing the depositor can do is to try to with-

draw his money. Banks are run by bankers. It is immaterial for most practical purposes by whom they are owned.

Bankers do not exercise their powers in trust for their stockholders, depositors or clients. The game for the banker is to exercise his powers within the law so as to make as much money as possible for himself and at the same time to try to safeguard the interests and funds entrusted to him. If without violating any of the legal rules of the game, a banker enriches himself and loses his client's money in so doing, as many of the sponsors of the finance companies, holding companies and investment trusts have done, there is no criminal or civil liability attaching to the banker. He has not been guilty of criminal negligence. He has merely made mistakes and the investors have had bad luck.

It is the banker's privilege to be highly compensated for losing other people's money and for selling them overpriced investments. But we cannot proceed with the discussion of banker management of banks without running afoul of the complexities of the whole problem of banker management, which at present is in a state of hopeless legal confusion. We shall, therefore, continue with the discussion of the seller-buyer relationship, in the broad field of security financing, where the average reader, as a buyer of securities, will have had sufficient experience to make the subject seem fairly real.

In point of law, a banker's recommendation is only the optimistic opinion of a seller about a commodity he has to sell or would like to see sold by some one else. This is legally sanctioned puffing of his wares. A horse seller's recommendation, on the other hand, may, in many instances, be regarded by the courts of equity as the opinion of an expert given to an amateur which creates a certain responsibility of the expert for the judgment expressed. A horse dealer who sold to a trusting amateur a half-breed for a thoroughbred, or a horse for $5,000 which was worth about $1,000, might, in certain cases, be sued for rescission or damages and prosecuted for fraud. It would not be easy for the horse dealer to plead inno-

cently, like a banker, that he had been mistaken or that subsequent world changes had altered the value of his commodity.

An important difference between securities and horses is that the former are traded in and quoted on a market that is supposed to be open and free, but never is in reality. Any price registered by that market is presumed by law to be fair, no matter how absurd. Another important difference is that a banker's statement of price on offering a new security is not a representation of value. Furthermore, customers expect a horse dealer to act like a rascal and a banker to behave like a gentleman.

There are, of course, many other classes of merchants, in trade with whom an innocent purchaser has more protection than he enjoys in dealing with a banker who invites the trusting confidence of investors. For instance, if Tiffany's sold to an amateur a diamond at about the current price per carat in the most expensive shops for a perfect stone, and the diamond turned out to have a serious flaw, which the amateur buyer did not observe, the price would, doubtless, be held to constitute a representation as to the quality of the stone. Making a customer believe a $1,000 diamond is worth $5,000 is not considered constructive finance if done by a reputable firm. It is considered deceit and fraud.

The banker not only can sell a legitimate, though economically unsound, security for all the public is foolish enough, in a moment of mass hysteria, to pay for it; the banker can, not only recommend and sell any listed security at the market price, however fantastic; but, the banker can legally create an absurd price for his security by manipulation of the securities market and by artful propaganda. There are certain legal restrictions on the banker's manipulation of the market and on his use of propaganda. The law now forbids the manipulation of the market by creating quotations through washed sales. In rigging the market, nowadays, the banker must take a definite long or short position and conduct only operations involving an actual change in ownership of securities. Moreover, the banker may not tell lies, but, in the United States, he may create false

impressions by telling half-truths. If he avoids washed sales and lies, he has wide latitude in market rigging and propaganda. The market rigging method will now be explained.

One or more bankers would acquire a substantial interest in a given company, perhaps through a contract with the management to do its future financing. The stock of this company, it may be assumed, was selling in the forties. The bankers, who would have formed a syndicate for handling this business, would decide that the stock might, in the bull market of the late new era, be stepped up to eighty or even higher. It might be the plan, at or near some such higher level, to liquidate a long position in the company's stock, acquired by the market manipulating purchases. The resulting profit would be divided among the syndicate members, who would include the managers of the company.

Then, in other cases, the plan might be to put out a new issue of the same stock and liquidate slowly the long position with no great concern for trading profits or losses. The main profit for the old stockholders might consist in the operation of securing fresh capital by selling new equities at twice their value. For the bankers the profits might take the form of commissions and bonus stock paid out of the treasury of the company. The trading account losses would be paid by the company, out of funds contributed by the fleeced subscribers of new capital.

If it was a stock in which a majority interest was held by a few shareholders, the operations would be simple. The holders of a large block of the shares would be invited to participate in the pool operations. The manipulators would then have against them only a limited quantity of stock liable to be dumped on the market when prices began to move upwards. If a number of shares, deemed sufficient, could be thus kept off the markets, and if the credit resources of the syndicate members appeared adequate, the operations would begin. There would be two simultaneous processes: First, there would be a flood of bullish propaganda about the company. The statements would all be facts, prepared by experts to masquer-

ade in the columns of the newspapers as news and not advertising. Second, every day a little more of the free stock would be bought at a higher price level.

Now, if the public caught on satisfactorily, the syndicate might be successful in pushing the stock up a few points every day without acquiring any considerable long position. The outsiders would be obligingly taking and carrying the long position for the syndicate. When the time was ripe, the syndicate would proceed to liquidate its holdings and blocks of the pooled stock to whatever extent suited the plans of the arch-conspirators, or the new stock would be put out at the higher price.

Market rigging was a popular technique in unloading the South American bonds on a gullible American public. Banking syndicates would bid up the prices of outstanding bonds of a weak credit South American government and maintain for a short time an artificial market in such securities preparatory to offering a new issue. This was called "dressing up the market." The artificial market would be maintained for a given period after the offering of the new issue so as to allow retailers time to sell their allotments, though, often, not long enough for this purpose. Then the plug would be pulled out and the issue would at once sell several points off the offering price. Most of such bonds are now in default.

The foreign government would have the proceeds of its borrowing debited with any losses incurred on the trading account of such market rigging operations. These debits would be called "expenses of the loan." Obviously, it seemed both to the New York bankers and to the borrowing politicians good business to spend a few hundred thousand dollars on trading account losses, if the operations enabled the borrowing government to unload on American investors fifty or a hundred million dollars' worth of its bonds at a price two to five points higher than would have been obtainable in a really free market.

In such ways the investors had their money used to rig the market to their own disadvantage. It is a fair speculation whether, even in American equity courts, the original pur-

chasers might not find relief, provided they could prove the agreements and operations which passed. But a hundred thousand dollar lawsuit would hardly be justified for a few thousand dollars' worth of bonds.

If strong terms have been used in describing certain financial practices, they have authority in British court decisions. Back in 1892 in England one of these market rigging syndicates turned out unsuccessfully, as may well happen, except during a remarkable bull market. Accordingly, an action was brought in equity by one of the parties of the syndicate against a member for recovery. The syndicate had lost money for the plaintiff because the public had not "caught on," in the language of the syndicate's correspondence. The defendants set up the altogether honest defense that the whole business was crooked and that, in consequence, the plaintiff, who had been a party to the conspiracy to defraud the public, had not come into equity with clean hands.

The Queen's Bench,[3] after throwing out the action of the plaintiff, took occasion to spread on the record some excellent law. The court said:

"If persons, for their own purposes of speculation, create an artificial price in the market by transactions which are not real, but are made for the purpose of inducing the public to take shares, they are guilty of as gross a fraud as has ever been committed and of a fraud which can be brought home to them in a criminal court."

After laying down *ex turpi causa non oritur actio*, the court went on to say:

"In this case the correspondence put in evidence by the plaintiff in support of the claim he made at the trial shows conclusively that the sole object of the plaintiff in ordering shares to be bought for him at a premium was to impose upon and to deceive the public by leading the public to suppose that there were buyers of such shares at a premium on the stock exchange, when in fact there were none but himself. The plaintiff's purchase was an actual purchase, not a sham purchase,

[3] Scott v. Brown, 2 Queen's Bench 1892-724.

that is true, but it is also true that the sole object of the purchase was to cheat and mislead the public. Under these circumstances, the plaintiff must look elsewhere than to a court of justice for such assistance as he may require against the persons he employed to assist him in his fraud, if the claim to such assistance is based on his illegal contract. . . . I am quite aware that what the plaintiff has done is very commonly done; it is done every day. But this is immaterial. Picking pockets and various forms of cheating are common enough and are nevertheless illegal."

The American courts, it would appear, have never been called upon to rule on a case of this sort. The reasons are doubtless mainly two in number.

First, these operations, when conducted by reputable American bankers and financiers, are made with expert legal advice and careful observance of certain niceties of speech. No such carelessly worded correspondence as that put in evidence in the British case would be allowed by American legal talent to pass between members of a New York syndicate.

If a member of an American syndicate were to discuss the operations with the intellectual honesty of a certain great Florentine, his colleagues would be pained beyond measure. The offensive realism would never soil any records. No reputable American banker would ever allow himself to entertain the thought that he could be a party to any such transactions as those of Scott v. Brown. Business standards have risen in the past two decades to such an extent that American business men usually talk among themselves more or less as their publicity agents write about them. They act, however, about the same as ever, as the recent losses of their victims would indicate.

While a New York syndicate was bulling the market, it would be said that its members felt that the security was selling out of line with its true value, or too low. When they decided to sell short, they would say that the security was selling out of line with its true value, or too high. There would be impressive data by economists, statisticians, engineers and other

experts to support both decisions. Banking decisions in this country are always ably rationalized by legal and economic counsel to make them harmonize with prevailing superstitions of the law and economics. The investor who loses can console himself that, unlike the victims of Jay Gould's financial freebooting, he has been legally done.

A second reason why no market rigging syndicate of reputable bankers is ever brought into court for conspiracy is that members of such syndicates rarely welsh. It was only falling out among the conspirators that brought Scott v. Brown into equity. The action was not brought by a victim or by the state.

It is only fair to say that market operations by bankers are often ventures involving grave risks, a fact which many bankers imagine lends great merit to the transactions when successful in unloading overpriced securities on the investing public. A group of bankers will buy up for several hundred million dollars common stocks giving control of a series of public utilities. They will then form a series of holding companies which, with the aid of market manipulations and propaganda, will create a market in which the bankers can unload securities of these holding companies at twice the value of their assets.

Had earnings continued to increase at the rate recorded in the exceptional years of security inflation, 1927-1929, the prices at which these new utility securities were offered might eventually have been warranted. The bankers now assert that they believed sincerely that earnings would maintain that rate of growth. In another breath they chide the American people for unwise speculative optimism. If the bankers' optimistic belief has been deceived, it was human to err. The general theory is that bankers are entitled to profits for foreseeing prosperity and that they are not to blame for hard times.

In conclusion, bankers are buyers of debts and investments and they are sellers of credit and investments. In plying this trade bankers are not fiduciaries or trustees. They command unusual financial power and the resources of management. Therefore: Bankers should not use their power, knowledge or resources as managers of other people's money for personal

profit in speculative operations of a "heads I win, tails you lose" character. Bankers should not give investment advice as confidential advisers. Bankers should not use selling propaganda in a way to constitute an undue influence on the market. The market should be free. It should register two opinions; and they should be about evenly matched. The banker should not conduct market operations which unduly influence the market and create fictitious values for securities. All of these are ideals, perhaps dreams. Their enforcement will be opposed by bankers. It might be made possible by public opinion and government regulation.

CHAPTER VI

SAFETY OF DEPOSITS; STABILITY OF VALUES

THE shortcomings of American bankers are the faults of the American people. Instead of requiring of them safety for entrusted savings, together with the conservation of honest and relatively stable credit values, the American people have demanded that the bankers conduct a get-rich-quick machine for gamblers and give the country prosperity by inflation, all of which has delighted and enriched the bankers. Instead of deploring an average of 800 bank failures a year over the last decade, the American people applauded the 400 per cent rise in two years of the market value of the stock of the nation's largest bank.

This chapter calls attention to the failure of the banks in fulfilling two responsibilities: First, the New York banks, holding, in the form of sight deposits, a large percentage of the liquid reserves of the country banks, have failed to keep their assets in sufficiently liquid form. Second, the New York banks have loaded down the banks of the country with a vast quantity of bad bonds.

Why did Mr. Hoover launch, on October 7, 1931, a dramatic appeal to the bankers of America to create a half billion dollar corporation to discount banking assets which are ineligible for rediscount by the Reserve Banks, uncollectible, and unsaleable at a reasonable price in the open market? The answer is that Mr. Hoover wished to check the increasing number of bank failures in the United States: 1,832 banks failed in the first eleven months of 1931 out of 21,903 banks; 522 banks failed in October, 1931, or just as Mr. Hoover was launching the National Credit Corporation. A billion and a half dollars of depositors' money was affected by bank failures in the first eleven months of 1931.

Let us look at the condition of the member banks of the Federal Reserve System as of the end of June over each of the five years 1927-1931.

(Figures in millions of dollars)

					Assets Eligible for Rediscount by the Reserve Banks			Borrowing by Member Banks from Reserve Banks
End of June	Total Loans	Total Investments	Total Assets	Total Deposits	U.S. Gov. Secs.	Com. Paper	Total El. As.	
1927	22,938	9,818	32,756	31,269	3,146	4,767	7,913	441
1928	24,325	10,604	34,929	32,138	3,576	4,647	8,223	1,096
1929	25,658	10,052	35,711	32,284	3,506	4,461	7,968	1,029
1930	25,214	10,442	35,656	33,690	3,412	3,905	7,317	274
1931	21,816	12,106	33,923	31,566	4,707	3,198	7,905	147

From these figures it is clear that there had been no decline in the ratio of assets of member banks of the Federal Reserve System eligible for rediscount since 1927. It is further evident that there had been a sharp decline in borrowing from the Federal Reserve System. These figures certainly do not indicate a need for any additional credit facilities for the nation's banks unless it be for the purpose of discounting doubtful assets.

If present market appraisals of bank investments in securities, such as bonds, be correct, Mr. Hoover's bank saving expedient must return upon the country's financial structure like a boomerang. No worthless asset was ever improved by a discount. Inflation to sustain fictitious values must always end in disaster. To ask all the banks of the nation to chip in 2 per cent of their deposits to form a credit pool for discounting worthless or nearly worthless assets of insolvent banks is not to strengthen the credit of the nation. It is evident that such inflation may save banks from closing when their liabilities exceed the value of their assets. But inflation can always make assets and liabilities balance by making liabilities worth less. Of course, Mr. Hoover can save the banks by having the Federal Reserve System put its printing press behind them.

Again it must be asked, why did the country need a half billion dollar National Credit Corporation when the outstand-

ing volume of Reserve Bank credit was at its lowest level in years? Has the Federal Reserve System failed? The answer is that the System has not failed of the objects of its charter. It has, however, failed to prevent the banks and the credit of the nation from getting into their present shape. And, now that they are in this shape, the System must fail to afford the desired relief of discounting worthless assets.

The Federal Reserve System was created in 1913 to avert a recurrence of the money panic which attended the 1907 collapse of the New York securities market. The System has given the country a flexible and stable currency. It has not, however, given America sound banking, wise credit policies or safety for deposits in 8,000 banks that have failed in 10 years. The System has made financial profiteering and unbridled credit inflation practicable with safety for the currency over a longer period than these evils could possibly have continued in the days before the creation of the System. The opinion just expressed was given public expression by an official and economist of the New York Reserve Bank. It is idle, of course, to expect that the Federal Reserve Bank of New York could exercise a restraining influence on credit inflation, as Mr. Warburg points out in his book might have been done, when one of the directors of the institution was a New York banker who was pouring oil on the flames of speculation.

It is evident that the directors of the Federal Reserve System cannot be trusted by the people of the United States to take the right measures at the right time to give the nation safe banks or sound credit and security values. Consequently, we have had the crash of 1929, the depression up to 1932 and the alleged need for a credit institution in 1931 to discount ineligible paper. The point to these reminders of facts is that only a vigorous and effective government warfare directed by men loyal to the public welfare can check financial profiteering and make the banks safe for the people's money. If the banks of America are loaded down with worthless and frozen assets, it is because the banks of New York overissued and oversold securities during the boom period, thanks to an excessive use

of credit which the Federal Reserve System could have made impossible.

It is significant that the present superintendent of banks of the State of New York was under four indictments, three charging neglect of duty and one conspiracy in connection with the failure of the Bank of United States, as this book went to press. One of the directors of that institution, who along with most of his colleagues was under indictment, was a former state superintendent of banks of New York State. Furthermore, the superintendent of banks who preceded the now indicted incumbent is serving a prison sentence for misdemeanors in connection with a recent bank failure.

In defense of banker optimism and use of credit, it may be argued that the bankers must stimulate investment and active trading. The answers to this argument are not hard to formulate. In the first place, banker influence has not been helpful in assuring a desirable amount of thrift, barring the admonitions of the savings bankers, who are uninfluential in financial affairs. The New York bankers certainly did not encourage thrift by leading people to seek fabulous gains from speculation and the purchase of investment trust stocks.

In the second place, bankers have neither the mandate, the wisdom nor the disinterestedness to guide the flow of the nation's savings into investment. What they should have done, but did not do, was to conserve sound credit values and the safety of bank deposits.

This book challenges with great vigor the popular doctrine that the banker has the mission of dictating our investment policies and ruling our industries. So far as an optimum allocation of savings among different fields of investment is concerned, no scheme of distribution can ever have objective validity. It must always be a purely subjective matter how the savings of the people are best invested. Social values as well as profit making must determine the investment distribution of savings. Whether we shall have decent homes for the people or white elephants in idle factories, apartment houses, office

buildings, ships or foreign properties, created by investors' savings, is not a question for New York bankers to determine.

Everybody has a right to an opinion on the subject of what shall be done with the nation's savings. As this is, supposedly, a democracy, the majority opinion should govern. Certainly a few hundred men in key positions in New York cannot claim to represent the entire nation in determining the uses to be made of its savings. Their function is to conserve safety and stability of values and not to give direction to the people's energies.

Any detailed discussion of technique, either of banking or of its regulation by the state, is out of place here. The theory and practice of averaging risks is well established by the insurance companies. The application of these principles to finance involves no considerations which need engage the attention of a layman. Public opinion need merely demand that the use of credit be curtailed and that its merchandising by bankers be conducted with a view to conserving stability of values and not to speculative profit-making by the bankers. As has been pointed out, all uses of credit are gambles. In so far as bankers have to do with credit, its creation or sale, they should operate, as nearly as possible, on a riskless basis. Insurance companies reduce risk taking to a riskless basis. Bankers can approximate the same achievement, but in so doing they cannot make speculative profits.

The subsidiary company has been a device through which most of the large New York banks have undertaken to profiteer and do legally with depositors' money what the law wisely forbids banks to do by themselves. The law properly forbids banks to engage in commercial ventures. Banks, however, have created dummy companies, in one instance sixty of them, whose directorates, control, administration and funds have been, for all practical purposes, identical with those of the parent bank. It would now be interesting to see published an itemized balance sheet of each of the companies of the large New York banks, showing their assets, at market value and cost price. The public knows something of the unprofitable

positions taken by these companies in innumerable commercial ventures and even in the stocks of their parent banks, as well as their holdings of now frozen German and other foreign credits. The public doubtless reflects its surmises through the 50 to 90 per cent decline since 1929 in the market value of the stocks of certain of the largest New York banks.

Nearly everything about these bank companies has been unsound in principle and unprofitable in practice. The big banker imagined that he could buy through the company into "good things" and resell his investments at a profit to investors. He did this quite successfully during the period of inflation, when interest and dividends were being paid by new loans. He went into Cuban sugar, foreign bank merchandising ventures like the Mercantile Bank of the Americas and the Bank of Asia, copper, radio, aviation and foreign credits—all "big shots" of the moment. Instead of trying to run a bank, the head of the New York large bank has tried his hand at running industry and world finance.

The result is that when things get into bad shape, he must run down to Washington and get the President of the United States to launch optimistic propaganda and billion dollar credit corporations. And the end is not yet. The path of inflation is a slippery road downwards. And the grim tragedy of all this inflation is simply that it does not serve to expand production, but merely to bolster up insolvent banks and to maintain for a time fictitious credit values. The bankers have merely lived up to the traditions of John Law and Jay Gould, but with greater legal finesse. Society has failed to protect itself. If the nation would now save its credit structure, without inflation to the point of endangering the gold standard, the government must make adequate levies on capital to restore the normal volume of production and commercial activity.

CHAPTER VII

INVESTMENT TRUSTS: A GREAT RACKET

THE investment trust is a corporate device of British origin which has been exploited since the war by American bankers as a profiteering instrument for themselves and a supposedly get-rich-quick scheme for investors. The bankers encouraged the public to buy at absurd prices securities of investment trusts, finance companies and holding companies—all birds of a feather—in the most preposterous beliefs about the prospects of profits from expert banker selection and management of investments, i.e., gambling in securities.

The bankers gambled with and lost other people's money to the extent of some two-thirds to three-fourths of the entrusted 3 billion dollars of principal. They profiteered in the losing of this money. That, in short, is the story of the American investment trust.

The only service the investment trust or any scheme of investment management can render, a legitimate one, is that of diversifying and averaging risks, losses and profits on capital used by others in production. The only money that can ever be paid by investment trusts as a whole, or by one trust in the long run, must be some part of the return earned by producers who use invested capital.

Managers of investment trusts can in no way be responsible for the act of saving the money which is entrusted to them by investors. If the managers fulfill the purpose of a sound trust, they will not assume responsibilities for the management of any enterprise or for any collaboration whatsoever in the processes of production, other than the service to the investor of distributing his capital among a diversity of enterprises. The exercise by investment trusts of managerial functions in or over

production violates the principle of investment diversification, which seeks safety in several independent managements.

The investment trust, fairly conducted, should be a "heads you win, tails you lose" proposition, with a professional compensation for the managers, proportionate to the size of the trust fund. The investor wins, approximately, whatever may be the average return, if any, on all invested capital. There should be a fee and neither bonuses nor profits for the investment managers. The reasons are the following: First, the managers should be encouraged not to seek profits, but an average return. The investment trust that goes after profits has already gone wrong. The quest of profit is gambling. The function of the trust is to minimize the gambling element. Second, the investment trust managers should conduct the trust as far as possible according to scientific rules and as little as possible by judgment. Third, the managers run no risks, suffer no losses, and hence deserve no profits for the earnings of industries and their actuarial services in obtaining an appropriate share of such earnings. For these services they merit only a fee. Many managers of trusts have, of course, lost in connection with operations, but they have done so because they have chosen to gamble heavily with their own funds.

It is essential to understand that when an investor entrusts money to an industry for use in production he authorizes the risk taking for profit necessary to production under the capitalistic system. This is socially desirable. However, when an investor entrusts money to a banker or trustee to invest, the banker or trustee should seek to minimize risks in the placing of such entrusted funds. In other words, bankers should not play the market for investors. These principles will be offensive to American bankers, but no one has the right to call them socialistic or opposed to capitalism.

Few investment trusts were ever conducted entirely in accordance with the principles just laid down. At the same time, the British investment trusts which have survived since the eighties—about one-fourth of those that started out—have been conducted with a large measure of regard for these prin-

ciples. Possibly some British investment trusts might demur at the above formulations as being somewhat rigid. Some managers might profess attachment to the principle of judicious selection. For instance, the British trust managers who, between 1890 and 1914, selected American securities as their field of specialization may pride themselves on the superiority of their judgment over that of other managers who favored Russia, Turkey or South America. The winner always believes in his judgment.

It is significant that Dr. Robinson, in a study of British investment trusts since their inception,[1] says, "In checking over the comparatively unsuccessful companies, it is not easy to point out any common cause of failure." The cause of failure is simple: they guessed wrong.

The investment trust first became significant in England during the late eighties when 3½ to 4¼ per cent money was going begging. There had been corporate enterprises engaged in diversified ventures since the beginning of the eighteenth century. The idea of the investment trust was probably evolved in Scotland, where, undoubtedly, the dominant thought was diversification for security. For the more speculatively inclined, the leitmotif was obviously a quest after higher profits overseas than were thought obtainable in British investments. The distribution of investments in a group of 48 representative British trusts showed 14.85 per cent domestic investments in 1914 and 29.59 per cent in 1922. In 1924 the capital value of the British investment trusts was in excess of half a billion dollars.

Diversification of risks has proved to be the only useful contribution which can be credited to British investment trust experience. Recent American experience has added nothing fundamental, though, in the applied mechanics of misleading a gullible public on the subject of investment, our bankers, ably seconded by university trained specialists in the social sciences, have shown marked superiority to their late Victorian predecessors. It is interesting to note that Professor Dewing

[1] Commerce Reports, No. 88.

stated in the *Harvard Business Review* of October, 1931, that a study partially completed at the Harvard Business School showed "that the English investment trusts went through the depression better than did our investment trusts."

It is remarkable how similar the adventures of the American bankers with investors' money in the post-war decade are to the investment trust rackets of the English bankers in the eighties. The following quotations from the London *Economist* may be taken as authoritative.

February 4, 1893: "Of many of the trust companies which were formed in such rapid succession a few years ago, when the mania for this form of joint stock enterprise was rampant, it may be said with truth that, having sown the wind, they are now reaping the whirlwind. . . . Week after week evidence accumulates proving only too forcibly that those responsible for the management of these trusts have based no inconsiderable part of their operations on false principles, with the inevitable result that after a more or less brief period of apparent prosperity, losses and difficulties have arisen, and unless greater foresight and ability is displayed in the future than has been shown in the past, it is highly probable that collapses of a disastrous kind will occur."

The following year, September 8, 1894, the *Economist* continued: "Just a year ago in our article bearing the same title as we have again adopted [Movements in Trust Securities] we gave a table showing how the trusts formed since the establishment of the trustees' and executors' corporation had fared in the estimation of the investing public, omitting a few small issues of founders' shares and a few other issues for which it was impossible to obtain reliable quotations. The table showed that securities having an original value of close upon £28,000,000 had depreciated to the extent of £9,600,000 or nearly 35 per cent. In addition, stocks of the nominal value of £2,200,000 were then absolutely unsalable, raising the total depreciation to not much less than 40 per cent."

Highly misleading representations have been based on partial statements of fact about the British trusts. In the first place,

the fact that the survivors are only about one-fourth of the entrants is entirely disregarded. In the second place, all the facts about earnings and dividends over long periods are completely suppressed.

Fifteen or twenty years hence, it may happen that a few American investment trusts will have survived and be paying 6 or 10 per cent dividends on their capital. In the meantime, however, these survivors will have been reorganized several times over. They will have reduced their nominal capital. They will have carried on for a number of years without paying any dividends, or with payment of only a small part of their earnings in dividends. In this manner these survivors will, over the years, have accumulated a large capital reserve, possibly equal to, or greater than, their capital losses in 1929-1931. The trusts will then be what bankers like to call "seasoned" investments. A "seasoned" investment is one into which early victims have put a great deal of seasoning. The important point, in connection with the present thesis, is that the original investors would have done far better over the years to have kept their money in a good savings bank or government bonds compounding at 2½ to 3½ per cent.

In America there have been since the war two broad types of investment trusts: the general management type and the fixed trust variety. Before the crash, the general management, or blind trading pool, species of investment trust was the almost universal favorite. Since the crash, the fixed trust variety alone has found favor, though, obviously, there has been comparatively little new financing in this field. The general management type of investment trust is the species most vulnerable to the criticism of these chapters. Its essence is a proposition which amounts, in effect, to the banker's saying to the investor: "Heads you and I split the winnings, as I may decide, subject to some vague limitations in the contract and to some slight regard for the laws of equity; tails you lose your money."

It is sometimes said that the bankers used bad judgment in putting out $2.2 billions of securities of investment trusts in

the nine months just before the crash. It is obvious, of course, that these issues helped to precipitate the crash by adding materially to the already heavy strain being made on the credit structure. It is naïve, however, to call these issues acts of bad banking judgment. Those were precisely the moments when the formation of the companies was easiest and most lucrative for the bankers. A planned economy under the competitive capitalistic system is an impossibility for innumerable reasons, and the exigencies of the investment market constitute one of the most important reasons. It is hardest to sell securities when the need for additional spending is most acute. Prosperity and economic order by means of credit uses must always be impossible over any long period.

In conclusion, the record of the best American bankers in their new rôle of investment trust managers is one of complete and conclusive failure to beat the results obtainable by any injudicious selection of a representative list of investments. That was to be expected. But this book does not make this failure the subject of reproach. The reproach is that the bankers took enormous originating profits, commissions and optional stock purchase warrants which could only be justified on the assumption that the judgment of bankers in selecting and managing investments had some value. There was no necessity for American investors to lose millions of dollars in commissions and profits to New York bankers to prove that banker investment judgment is worthless. The British had already proved it. Only production and service can create income—not gambling.

CHAPTER VIII

SUMMARY. THE LIMITATIONS OF FINANCE

IT SEEMS desirable. to close the discussion of finance with a summary presentation of three major ideas thus far developed and further brought out in the ensuing chapters on agriculture, foreign trade and foreign investments. The first idea is that social welfare and business prosperity cannot, over the long run, be maintained by uses of credit or the financial machinery. The second idea is that the outstanding problem of the moment and of the future is that of assuring adequate consumption and not of financing production. The third idea is that savers of capital cannot enrich themselves through any possible use of the financial mechanisms.

These points are not advanced as arguments to prove that capitalism is necessarily doomed to an early extinction, or that, in order to save capitalism, the existing financial institutions should be immediately ended or, even, drastically amended. Of course, no intelligent person can be expected to imagine that capitalism, or any other pattern of social institutions, is perpetual. The thought is, quite simply, that uses of credit and the financial mechanisms should be curtailed. At the same time larger use should be made of other means, progressively to be developed—taxation being the principal one—for promoting welfare and assuring adequate production. It is held, in conflict with recent teaching, that adequate consumption can never be assured by any possible use of the financial mechanisms, or of money, credit and banking. Adequate consumption must be paid for out of current, earned, money income. This is not a problem in the management of credit, banking or finance. It is a problem in taxation and regulation of wages and profits. It calls for the coercive power of the state and not the ingenuity of business managers.

Criticism of bankers and uses of finance is not an attack on capitalism. Producers and savers of capital—not bankers—are the backbone of capitalism. Producers and investors are nowhere attacked in these pages. The utility of certain banking functions is freely recognized. The bankers have been criticized for having made for themselves a profitable racket of the securities and financial arrangements of successful enterprises built up by others and also of governments enjoying good credit.

As for the phenomena of credit and finance, in their most significant behavioristic aspects, this book points out that they are largely mathematical. The fundamentals of the late bull market and of the South Sea Island Bubble of more than two hundred years ago were identical—because mathematics had not changed in the meantime. We know exactly what to expect of borrowing and speculation—and also of bankers. This book, therefore, has no new financial tricks to suggest. On the contrary, its basic recommendation, in this respect, is for fewer financial tricks.

For bankers, the problem of finance is profitable exploitation of its mechanisms. For society, the financial problem is not, as many excellent people suppose, that of avoiding losses and mistakes in the use of credit. Losses and mistakes are inevitable under any system of production. There is no evidence that they are greater under modern capitalism than under modern communism or ancient despotism. The problem for society, and the problem which the profit-seeking use of credit aggravates but can never solve, is that of distributing the burden of inevitable losses, mainly from wars and industrial mistakes, so as not to cripple the buying power and consuming capacity of the masses.

If the preceding chapters have emphasized the mistakes of the banker, the object has not been malicious, but to prove that there can be no such thing as a scientific use of credit for profit making.

If scientific credit management for profits be impossible, scientific planning of production, where profits are not sought, is a simple matter. Once profit seeking were eliminated, how-

ever, there would be no need for a use of credit. The kings of Egypt needed no credit to build the pyramids or to develop the world's greatest irrigation projects. Neither did the Incas of Peru need credit to create monumental public works and irrigation projects. The Russian communists have made some use of credit and this has been one of their mistakes which will give them trouble in no distant future. Fortunately for the success of their experiment, our Mr. Hughes, by making an American policy of non-recognition of Russia, saved the communist dictatorship from the evils of large scale foreign borrowing and the fate of the borrowing South American dictators.

The case against the bankers and the financial processes, however, is not founded on mistakes or rackets, though they make up part of the evidence. The point is that finance has got us into our present predicament and cannot get us out. Contrary to popular belief, we are not suffering today from the consequences of war destruction but of war financing. We do not want for things destroyed during the war, but for purchasing power in the hands of poor people to consume what now idle men and machines might produce. Financial experts in the White House, the Treasury and Wall Street and their financial mechanisms have not for over two years been able to create a demand for the necessary output of our idle workers and productive plants. That, in a nutshell, is the case against finance and business—not mistakes and rackets.

Many people, still loyal to their business gods, imagine that better economic planning might have averted the present situation. They talk about planned production. It does not seem to occur to them that the real problem may be planned consumption. Let us give brief consideration to the planning idea, as, in the present economic pattern, planning of production would have to be carried on mainly in the field of finance.

In the autumn of 1931 the United States Chamber of Commerce proposed a National Economic Council of five business men to act in an advisory capacity with a view to preventing, as far as possible, the recurrence of depressions. At about the

same time, the American Federation of Labor, in its annual convention, suggested an economic council to be sponsored by the government and initially formed by the President of the United States for the same purpose and to conduct long range investigation into the causes of depressions and unemployment.

In England, Mr. E. H. Davenport, in his lectures before the Liberal Summer School in 1931, advanced a more definite set of proposals. He urged a cabinet committee on economic affairs with a loan council to approve issues of securities. He would create and cause to function a board of national investment. He stated: "The theory of any state economic plan is, briefly, that investment [expenditure on capital goods] should not lag behind savings [purchasing power put into the money machine]. The practice involves directing investment into channels conducive to the maintenance of national employment at the highest possible level."

The American proposals hardly merit serious consideration. They ask for little more than a fact-finding advisory committee, whose information and recommendations seem likely to exert less influence on financial policies than did the attempts of the Reserve Bank of New York in 1929 to check security inflation. Mr. Davenport's proposal, on the other hand, merits far more discussion than can be given to it in these pages. The only brief criticism that suggests itself on a superficial examination of his proposal is that the emphasis is misplaced, and that his proposal should be called, and developed as, a system of state capitalism. The dynamic force in economic affairs is not investment, but an effective will to consume. Nearly all capitalists and most socialists fail to recognize this fact. An inadequacy of consumption can never be cured by management of production or investment. The will to consume is a purely spiritual factor. Where there is a will to consume, there is a way to produce and to save what may be necessary.

The success of communism or fascism and the futility of liberalism are explained largely by the fact that communism and fascism are living religions and that man is an emotional being. For the creation of its necessary markets, capitalism, in

the past, has had to rely on spiritual impulses derived from non-commercial sources, mainly from militant nationalism and the love of adventure. Financial mechanics and tradesmen, aided by academic technicians, can never lead or inspire any people to increased economic activity. If, as it seems, American big business men, such as Mr. Swope and Mr. Young, are caressing the idea of a vague sort of economic fascism, they might do well to remember that, in order to make it work, they will need an ex-socialist like Mussolini or Ramsay MacDonald for their dictator. The people must have a prophet, and prophets have never come out of the world of profits.

Now the advocates of economic planning under capitalism, whether big business men or those who call themselves liberals, all seem to overlook a number of important though simple facts. First, capitalism is a system of competition and not of cooperation. Second, business lacks orders for goods, not plans for their production. Third, there is only one cure for insufficient purchasing power in the hands of consumers and that is to give them more, not lend it to them. For insufficient spending, there can be only one remedy, and that is more spending. This means making those people spend more who are able to do so. All this does not require the planning of production. It calls for the exercise either of the coercive power of the state or of some spiritual force which business men and experts do not know how to generate. Fourth, business men have always planned. Never did business men plan with more expert assistance or better information than during the past ten years. And never were greater financial follies committed. Our present situation is the result of business planning in Wall Street and Washington, unchecked by adequate social counterplanning. Fifth, business men can plan only for profit making. Every man to his trade. Sixth, planning for profit making can never be done scientifically. The better the planning for profits, the more certain is the ultimate result of profitless business.

In conclusion it ought to be said that, in order to insure economic chaos and a lack of demand for the full output of

workers and productive equipment, the best thing that can be done is to put bankers and business men to planning. The next best thing is to put them in control of government. They will economize, lower the taxes of the rich, reduce costs, cut wages, and throw men out of work, all by way of producing cheaper goods. They will achieve perfectly amazing success. Goods will become so cheap that nobody will be able to buy them. Then the business planners will pass the hat for the men they have thrown out of work. All this is hardly prophetic. It is historic.

Of course, the communists have a planned economy and, of course, it works. Any average army second lieutenant, vested with full dictatorial powers, could be trusted to keep our productive plant going at full speed as long as he remained dictator. The second lieutenant might have to be a Napoleon to seize the power, but conducting a planned economy would be relatively easy in a country like the United States.

The dictatorship, however, would not avoid mistakes or losses. Nor would it make profits. The dictatorship would not have to make an even distribution of national income. Some might live in palaces and others in tenements, but distributed income would always have to be fully and promptly spent or invested according to the plan of the dictator, as Mr. Davenport's reasoning recognizes. But, let it be repeated, without profit making, there is absolutely nothing to this achievement.

To restate the central theme of this chapter: Uses of credit are gambling operations for profit. The financial processes, and most of all the use of credit, cannot make money for investors; nor can they stabilize production or assure steady profits for producers. The greater the gambling, the greater the winnings and losses; consequently, the greater the instability. Production with proprietor's capital is a gamble on the future of prices; but holding proprietor's capital idle is equally a gamble. Production on borrowed capital is much more of a gamble. Every undertaking to make a profit is a gamble. There can be no science of gambling; hence, no science of planning profits. The factors of economic chance are unpredictable because they

are largely subject to human control. And you never can tell what human beings will do or want next.

Balancing production with consumption in any attainable volume, without profit making, can be scientifically planned and conducted over any length of time. It has been done. But this achievement by human beings means state capitalism, a despotism or communism.

Under a limited régime of individual capitalism it may be possible to achieve a fairly high degree of stability and balanced production and consumption at a high level by having regard for the following two principles: Principle Number 1 is even distribution through the investment processes of the average return on all saved capital. As this return has never been high, it would not need to be reduced, but merely divided with great evenness. This would mean losing more through taxation and less through commercial white elephants. Attempts in this direction would take the form of curtailment of the volume of credit; the use of more proprietor's and less lender's capital; and the restriction of speculative operations by the financial institutions. Principle Number 2 is more even distribution of the total national income to be effected largely by means of taxation and the regulation of wages and conditions of labor. Taxation effects spending, consumption and equalization of income.

This book does not argue for the elimination of all speculation or of all borrowing. The right to speculate must be preserved, if we are to enjoy any measure of economic liberty and if we are to have capitalism. Any desirable social order, it would seem, should allow the people as many ways of making fools of themselves as can be safely tolerated. The success of the social experiment will, of course, depend on the degree of moderation with which folly is practiced. If the people make a cult of some one brand of folly, such as credit uses, naturally the experiment becomes unworkable.

If there were a science of credit management or profit planning, we should only need to learn it from the teachers of money making in our endowed business schools and then prac-

tice it intensively so as to hasten the advent of Mr. Hoover's "day when poverty will be banished from this nation." There being no such science, why talk about planning production for profit? And, if it is desired to plan production without profit, why not take a perfectly good working system in operation in Russia?

In the remainder of this chapter it will be shown that the arguments advanced against borrowing have been given far more practical recognition than is generally realized. Two classes of examples will be discussed briefly: the larger American corporations and the producers of certain older countries like France.

As for the larger corporations, Professor Lauchlin Currie, in an article entitled "The Decline of the Commercial Loan,"[1] showed that between 1900 and 1914 commercial loans were between 45 and 47 per cent of the total earning assets of all national banks, while during 1929 they had fallen to 37 per cent. He also showed from an analysis of the current assets and liabilities of over seven hundred of the larger corporations during the past decade that their use of credit on short term was steadily declining. It seems unnecessary to adduce figures to show the increasing replacement of bond financing by common stock financing. In the following paragraph Professor Currie goes to the heart of the problem:

"The theory that makes the temporary saving of interest the main motive for borrowing is essentially a theory of static conditions. It assumes implicitly that the borrower's own capital and long term borrowings can be continuously employed and that there are no cyclical variations in output and profits. From a dynamic point of view there are dangers inherent in the practice of borrowing which, in the eyes of the larger industrialists, far outweigh the temporary advantage of a small saving in interest charges. The dangers are those associated with trading on a margin. It is surely obvious that, other things being equal, the more heavily a company is in debt,

[1] *Quarterly Journal of Economics*, August, 1931.

either for long or short periods, the more its net earnings fluctuate and the greater the dangers of bankruptcy."

The American Bankers Association looked askance at the decline of the commercial loan and of bond financing before the crash, but these trends persisted. After two years of the present depression, with several hundred million dollars of bond coupons in default, one can only say that it is singularly fortunate for the larger corporations that most of them are spared from bankruptcy or receiverships by reason of the fact that their capital has been furnished mainly by proprietors and not by lenders. Unfortunately, however, while strong companies like the United States Steel Corporation were financing themselves without borrowing, individuals were using credit to buy real estate and securities at inflated prices. Obviously, one of the greatest mischiefs wrought by such borrowing was the creation of absurd prices and of the consequent necessity for a crash to deflate them. The unhappy consequences of borrowing have already been amply discussed.

As for the use of credit in countries like France, it is most significant that France has always been a small user of private credit: (The government, of course, has, since the Franco-Prussian War, used borrowing as a source of revenue or ultimately as a means of levying on 80 per cent of the loaned capital.) France is so backward in respect of credit that discounting a draft is not well seen. It is done, but the practice is discouraged. If a producer has not enough capital to finance an expansion of production to take advantage of a new piece of business, ordinarily, he leaves it for others. He refuses to go into debt or surrender control of his business to a contributor of outside capital. It was largely for these reasons that French *rentiers* threw away a large part of their savings in Russian, Egyptian, Turkish and South American bonds which have gone bad. There should, of course, have been more domestic waste to absorb these savings.

To an American trained in our recent credit doctrines, it seems monstrous that a small producer, in a country gorged with gold, should fail to borrow and expand whenever he sees

a good chance of making a profit. As a practical matter, however, something akin to the French attitude towards borrowing for expansion is the only effective means of maintaining comparative stability and healthy growth under the capitalistic system. Once everybody gets the notion that an intelligent use of credit can be made to yield a profit, stability becomes impossible. Everyone naturally thinks he is intelligent. If he did not have that belief about himself, he would not be in business. The rest is the old story. There is no science of picking winners. If there were—but why make an Irish bull? A thousand borrowing efficiency experts seeking profits will work their own ruin quite as surely and rather more swiftly than a similar number of incompetents. All that is gained from superior efficiency is ultimately lost in price declines.

It remains to stress one final consideration. Capitalism is growing old. Optimism in borrowing and financial speculation was appropriate when the world was full of capitalistically young countries. Capitalistically considered, both England and Germany (as well as the Americas, Australia and South Africa) enjoyed a period of youth as they entered upon their industrial development. Our frontier days are over and the last of England's three great monopolies—manufacturing, shipping and banking—is now in liquidation. It is important to understand that, while former economic crises were distempers of youth, the present depression is a disease of old age, the old age of capitalism, of course, and not of the human race, which will probably not grow old until the beginning of the next glacial period.

Capitalism may, possibly, survive the present crisis. The question is whether or not it will thereafter enjoy a pleasant old age. The answer will depend in no small part on how much countries like the United States, England and Germany can learn from lands like France and Iceland, which, capitalistically speaking, never had any youth. It is important for an old man to find out in time that he is old and act accordingly.

Up to the World War, the United States, Canada, Australia and South America could use credit recklessly, take the con-

sequences of cyclical depressions and feel assured that prosperity was always waiting just around the corner. In America this was called the virtue of optimism, and in England it was blundering through. Those who today talk of inspiring confidence instead of facing the realities of old age are trying to live in the past. They will, however, wake up in the present.

What is happening today in respect of credit, Adam Smith foretold in 1775, but his gloomy predictions were completely belied by the events of the nineteenth century, thanks to the industrial revolution and the opening up of four new continents. Over half a century after the *Wealth of Nations* had been published, a smug, superficial, British historian, Lord Macaulay, with a juvenile economic philosophy as American as it was British, smiled condescendingly at Adam Smith's alarm over the growth of the British public debt. The debt had increased sevenfold since Adam Smith's death, but the national wealth had grown faster than the public debt.

But the events of 1931 have finally vindicated Adam Smith. Compound interest will eventually overtake any growth in wealth. Mathematical logic is always right, given enough time. The infantilism of American and British economic philosophy consists largely in basing conclusions on the happy experiences of a short period.

The criticism of this book is not destructive. Capitalism is destroying itself or disintegrating with age. The book advances suggestions of moderation and restraint which might, if followed,—and they probably will not be,—prolong and render more pleasant the old age of capitalism.

In the declining years of capitalistic old age, assuring adequate consumption to balance a requisite volume of production is the problem for the coercive action of the state—not for planning by profit makers or producers. Capitalism has always depended on the state, whether for war profits or tariff protection. In its old age, a senile capitalism must be nurtured by the state, not with war profits, necessarily, but on an even diet of 2 per cent gruel. Capitalism has run down for want of new worlds to conquer. The eternal association of men, now ex-

CHAPTER IX

FARMING: BUSINESS OR WAY OF LIFE?

THE plight of agriculture is one of the most important aspects of the present depression. This discussion is an attempt to point out what is wrong in agriculture. The conclusion reached is that the farmer, and not production, is the agricultural problem. The larger implication of this conclusion is that farming is primarily a way of life and secondarily an industry. It is a way of life for over a fourth of the American population and for about a half of the world's inhabitants. The farmer's problem is not how to make money, but how to live happily on the soil. Some money making, or production of money crops, must, in a highly industrialized and specialized age and country, form a part of any likely solution of this problem.

Welfare, however, which means emphasis on security rather than profits, should be the farmer's chief preoccupation. He should realize that the pursuit of profits is not synonymous with the pursuit of happiness. Too much business and too much debt have proved the farmer's undoing. His salvation and, possibly, that of society can be found only in his greater independence of business and his escape from debt. Such is the gist of the argument to be developed in the next few chapters.

It used to be the supposedly clever remark to make about the farmer to say that he was a bad business man whose troubles were largely due to his comparative inefficiency. Senator Lodge, sounding the keynote of the Republican Party program at the Republic National Convention in 1920, declared impressively, "The most effective remedy for the high cost of living is to keep up an increased production; particularly should every effort be made to increase the productivity

of the farmers." The Democratic Convention expressed similar views. When these counsels were given, wheat was selling around $2.25 a bushel. Within a few weeks it had dropped to 93 cents. During most of 1931 wheat was selling between 40 and 65 cents a bushel.

The facts about agricultural production have never furnished support to these views. According to the Department of Agriculture,[1] the index of total crop production in this country, taking the average for 1910-1914 as the base, has been as follows:

Period	*Index*	
1905–1909	94	
1910–1914	100	
1915–1919	108	
1920	117	(When Mr. Lodge urged more production to reduce the cost of living)
1921	100	(When prices had dropped 40 per cent)
1922–1930	112	
1928	119	(Peak year)
1929	114	
1930	106	(Production lowest since 1921 and agricultural prices falling).

It is clear from these figures of production that the high cost of living in 1920 and the farmer's troubles since 1920 may not be attributed to underproduction or inefficiency. There are today nearly 4 million less people on the farms; 20 million less acres in crops and 20 per cent more of potential agricultural production than in 1920. Agricultural output per worker increased 47 per cent between 1900 and 1925, and 25 per cent between 1919 and 1929. The output per worker in manufacturing increased only 33 per cent between the periods 1908-1910 and 1924-1926. In 1925 ten persons employed in agriculture were turning out the same product as fourteen persons in 1910 or twelve in 1920. Has efficiency helped the farmer?

The economic thought of the world is ruled by many falla-

[1] *Crops and Markets*, December, 1930, page 506.

cies, none of which is more sinister than the notion that the farmer's troubles are mainly due to inefficiency in, hindrances to, and inadequate facilities for, producing and marketing his products. The economic experts in the Final Report of the World Economic Conference at Geneva in 1927 said:

"The Conference draws the attention of the governments to the fact that high rates of interest and heavy taxation hamper production."

Why, asks the realist, have high interest rates and tax rates not hampered production sufficiently to prevent agricultural prices from falling 60 per cent during this period?

"The agriculturist should find his just remuneration not through speculation but in the regulation of prices permitting him to reckon on a legitimate return equivalent to that accorded to other producers."

How, asks the realist, can prices be thus regulated under a system which the free trade experts contend should be more freely competitive? And how can farm prices be kept stable when farmers are urged to increase production with the aid of excessive amounts of loaned money? The experts go on declaring that agricultural credit facilities are inadequate. The Report of the Geneva experts continued:

"Unless practical measures are taken to restore the price equilibrium, it is to be feared that sooner or later there will be a *diminution* in agricultural production detrimental to the welfare of mankind. Technical means exist, however, for a considerable development of agricultural production. They must, therefore, be put into operation. Their general adoption would have the most beneficial consequences for the prosperity and economic peace of the world."

Words, mere words! How hollow they sound four years after they were solemnly handed down for the economic guidance of statesmen. How natural and even fortunate for mankind that statesmen pay so little attention to the counsels of experts. Price equilibrium must always be a chimera in a competitive world and never more so than in the post-war period when keen competition has been preached and prac-

ticed as never before. How futile of experts to emit pious wishes for price equilibrium without indicating feasible means for its attainment. The fears of the experts as to inadequate production are simply laughable. The trouble with business men and economists is that they have been trained to think in terms of production and profits. Fears which the experts, business men and statesmen rarely allow to influence their policies, however, have been fully justified. There is superabundant production, but there is also a superabundance of unemployment and human misery.

Since 1920 prices have maintained a secular trend downwards the world over. Tariff and trade hindrances have multiplied. Agricultural credit has been redundant. Agricultural production has been overabundant. Nevertheless, the international economic and business experts are actually clamoring for more loans to agriculture. Only a year ago (January, 1931) the Financial Committee to the Council of the League of Nations reported favorably on a fantastic scheme for the creation of an International Agricultural Mortgage Credit Company.[2] The reasons given for this proposed institution were that

". . . a lack of capital is one of the major factors preventing agriculturists from changing from those crops in which there is at present excess to those the consumption of which is tending to increase."

Agricultural credits, it is argued, would increase the purchasing power of agriculturists, particularly their demand for industrial products. As has already been pointed out, inflation always increases purchasing power so long as fresh borrowings exceed interest payments. If people have insufficient purchasing power before going into debt, it invariably happens, where large numbers are involved, that they have considerably less when they have reached the end of their borrowing rope. Prices fall faster than production can increase. During the first eight months of 1931, the Argentine, an agricultural country, increased the volume of her exports 72 per cent over

[2] C. M. 375 M. 155.

the volume for the corresponding period of the preceding year and received 3 per cent less money for them.

The League of Nations Financial Committee sagely points out that the proposed agricultural company "should guard against the risk of an injudicious increase in production." Unfortunately, these wise men offered no suggestion as to how a judicious increase in production may be determined. After all, what is "an injudicious increase of production" but one that turns out badly? The experts fail to grasp the obvious fact that all uses of credit and all business decisions are judicious. Men bereft of judgment are nowhere allowed to make contracts.

The obvious fact about all business decisions is that they are guesses about the future. Like all other judicious acts of human beings, they are subject to a large and varying percentage of error. There is no valid reason for supposing that uses of agricultural, or any other type of, credit would be accompanied by fewer errors today than they were ten or fifty years ago. The point overlooked by the League experts is that agricultural credit has not proved more helpful than harmful since the war.

The two major contentions of this book in respect to agriculture are that too much business and too much borrowing have been the chief undoing of the farmer, and that the remedy is to be found in gradually taking the farmer out of business and out of debt. It may be asked whether farming is more of a business now than it was twenty or a hundred years ago.

The answer is, Yes. Up to the commercial revolution of the seventeenth and eighteenth centuries, farming flourished everywhere but was nowhere a business. Since the rise of modern business in the seventeenth century, roughly speaking, farming has been in part a business and in part a way of life.

Now, a certain amount of trade, even before the rise of business, has always been carried on between farmers and townsfolk. With the rise of low cost, machine-made textiles, house furniture, tools, implements and articles of familiar use, country people have found it, or thought they found it, advan-

tageous to trade a larger proportion of their production for such articles. Farmers have tended to import more and more goods from the city and, consequently, to export more and more agricultural goods to the city in payment of these purchases. They have thereby followed the principles of free trade, division of labor and specialization.

As long as such trade remains a process of barter, untrammeled by long term debt, its volume is self-regulating. Its growth cannot be said at any given point to convert the farmer into a business man. Whether a farmer consumes 80 per cent and sells 20 per cent of his production, or vice versa, is not a crucial question on which turns the definition of his status as a farmer or a business man. After all, the members of the religious, learned and military professions have always traded their personal services 100 per cent for the goods they have consumed, yet one would hardly call them business men or tradesmen.

There is one momentous decision which any man has to make in order to merit classification in the ranks of business. He must decide to make risk taking for profit a principal element of his vocation. Specialization in one or two money and export crops combined with long-term borrowing make a business man of the farmer. The unhappy consequences of these policies will be discussed in a later chapter.

American farming began to "go business" mildly after the Civil War, and in the grand manner after 1915. Overindustrialization of certain European countries, notably England and Germany, created between 1870 and 1914 a growing demand for imports of foodstuffs. Up to 1900, thanks to this demand, to free lands, to a heavy immigration of agricultural workers, to the building of new railways and to the use of improved farm machinery and methods of production, our exports of food expanded rapidly. Our exports of wheat jumped from 35 million bushels a year in 1867-1871 to 133 million bushels in 1877-1881; and to 197 million bushels in 1897-1901. Happily for the farmers, however, during the period 1900-1914, our exports of foodstuffs declined. Cereal exports dropped from

450 million bushels in 1897 to 150 million bushels just before the war. Wheat exports averaged only 79 million bushels a year from 1910 to 1912 as compared with 235 million bushels in 1902. Growing exports of cotton and tobacco, however, maintained a fairly large volume of total agricultural exports.

Why were American farmers exporting less foodstuffs in 1900-1914? European demand for these imports was on the increase, but Australia, the Argentine and Russia were supplanting our agricultural exports in European markets, most happily for American farmers. At the same time our population was growing rapidly from unprecedented numbers of immigrants, most of whom, unlike the immigrants of the preceding fifty years, were settling in the cities. We, therefore, needed our increased food supply for home consumption. This period of dwindling food exports and expanding production for the home market was one of sound agricultural prosperity and economic progress. From 1900 to 1914, according to the statistics of the United States Bureau of Labor, the price level of all commodities rose 25 per cent and that of farm products rose 49 per cent. During this golden age for American agriculture, Australian farm prices rose only 20 per cent notwithstanding feverish exportation of wheat, meat and wool.

The figures of agricultural prosperity in America during a period of declining agricultural exports should be pondered by that large school of economic thinkers who see the farmer's only salvation in increased exports. The same school of thinkers should also meditate the fact that today agricultural distress is most acute among the producers of export crops, notably the wheat farmers of the Northwest and the cotton farmers of the South. The invariable connection between agricultural distress and a large percentage of export crops is not accidental.

Alas, like every garden of Eden, this happy era for American farmers had to be terminated by the outbreak of the World War. That cruel tragedy inflicted on the American farmer, after the initial period of suspended exports, the universally welcomed disaster of business prosperity. The larger aspects of our

war-time export prosperity will be analyzed in the chapter explaining the geneses of our foreign investments.

Had the profits of this war prosperity for agriculture been used to buy war bonds and had farmers been prevented from borrowing, even with the income on such Liberty bonds, farmers would still have found war prosperity costly over the long run. But, instead of making hay while the sun shone, the farmers made debts. Since the war they have had a 250 per cent increase in taxation, and 300 per cent increase in self-imposed interest charges to bear. But all the while their money income has been declining, so that now it is below the pre-war level. The story of the farmer's tragic degeneration into a business man and a debtor would be a fit subject for Hogarth. The story of the debtor's progress will be told with a few figures in the next chapter.

American farming is now much of a business, and a pitiful business it is. For the past two decades experts and friends of agriculture have been trying to assist farmers to be good business men. It must now be acknowledged that their success has been distinguished. They have aimed at cheaper and more efficient production. And how they have achieved it! The catastrophe of business leadership is its success.

It is particularly germane to state that those broad fields of agricultural enterprise in which considerable risk taking for profit has been a dominant characteristic since the rise of business during the commercial revolution have proved socially the least desirable areas of rural life. The sugar and cotton plantations of our southern states, of the West Indies, and of South America; the large absentee owned estates of Russia, Ireland, Rumania and eastern Europe; and the rubber, tea, rice and coffee estates of the East, of Africa, and of Brazil are all examples of agriculture conducted efficiently and on a business basis.

These properties, whether worked by slaves in the earlier days, peons, serfs, indentured laborers, tenant and share farmers under the modern American debt slavery system, or hired hands, have always been foci of festering social evils. The en-

terprises have usually been conducted on factory principles, often with large reserves of liquid capital and lines of credit. In typical business fashion they have reacted to world changes in supply and demand with catastrophic swiftness. Impermanence has been the characteristic of ownership, and violent fluctuations the normal feature of administration.

In always striking contrast with these malodorous zones of industrialized agricultural exploitation, there have flourished elsewhere in the world the pleasanter and less convulsive fields of agricultural enterprise in which risk taking for profit has been conspicuous by its absence or relative unimportance. There is, of course, an inevitable element of risk and profit connected with nearly every occupation, but this element cannot be said to have been important in the life of the American farmer or the European peasant before the war. He has always had taxes or rent and, in some cases, a little interest to pay. He has needed to sell some of his products to obtain money with which to buy some of the necessities of life. But he has not needed to worry about realizing enough from the sale of his products to meet these requirements. He has not needed a set of books to know whether he was solvent. His fate has not hung on the quotations of Liverpool.

For this sturdy, self-reliant, comparatively debt-free farmer, the worst that hard times have ever meant has been less from the outside, less saving and more hard work—never evition or unemployment. In the America of 1931 starving farmers have had to be fed by public charity. Before the war whenever a Russian wheat crop failed, world wheat prices would rise and the French peasant would buy more Russian bonds. When crops were normal, prices fell and the French peasant would buy fewer Russian bonds. As all his pre-war Russian bonds are worthless and his French bonds shrunken at least 80 per cent in value, the difference between good and bad years, so far as the French peasant is concerned, has not been great over the long run. In good years the American farmer bought more land, more live stock, more implements and lived better—a far better investment for any farmer than paper securities. In

poor years he accumulated less but remained relatively secure. Credit and abject dependence on export crops have destroyed this security.

There were several periods in the newer countries when land booms, usually financed by capital imports, upset these healthy conditions. In general, it may be said that in measure as agriculture has developed business ways human welfare has suffered.

During the World War, the United States proceeded on the assumption that government interest in agriculture was limited to production. As Messrs. Stodyk and West point out in their book on the *Federal Farm Board* (page 117) the keystone of our war economic philosophy was expressed by the Food Administration. "Its [The Food Administration's] effort is to maintain a price that will remunerate the farmer and thus stimulate production, for production is the keystone of winning the war." Some four million men were stimulated without such remuneration to produce services which the country seemed to find quite valuable at the time. Our President and business men, however, have recently evinced great hostility to their further remuneration in a pecuniary way, but that is another story.

Beyond the war period no one in authority in the United States seemed to care a straw. The Government wanted goods to win the war. Business wanted profits. The war is said to have been won. Business got the profits. And the farmers got higher taxes, bigger debts and smaller incomes.

On the continent of Europe price regulation prevented such wild excesses in land value inflation and credit uses as our farmers committed. The effects of such unwise uses of agricultural credit as were made have been annulled by currency devaluation. England is at last being forced to recognize that there is only one thing to do with impossible debts and that is not to pay them. Debts can be repudiated, after the fashion of the Soviet Government and several southern states in the United States. Debts can be wiped out by currency devaluation. And, lastly, debts can be canceled along the lines now

being followed in the United States and abroad: bankruptcies and defaults. But the farmer is the last man to default because his farm is his home and a man will suffer a lot before he will render himself homeless. He, therefore, pays as long as he can through a reduced standard of living and to the paralyzation of trade.

CHAPTER X

DEBT, THE FARMER'S NEMESIS

THE trend of agriculture towards business ways and long term debt has been marked by an increasing disparity between the return received by agriculturists and that received by other producers. Capital, management and labor employed in agriculture have been producing a larger and larger output and receiving a smaller and smaller return. Their return is at present less than half that received by other producers. The fact of this disparity, which will be shown at greater length in Chapter XII, suggests that debt has borne unfortunate fruits for the farmer.

In developing the case against business ways for farmers, this chapter states certain salient facts about agricultural credit. Some of these facts, unfortunately, have to be statistics. Emphasis will be laid on the fact that debt has served mainly to finance an unsound inflation in land values. The fundamental argument against agricultural credit is that perpetual borrowing, with its inevitable corollary of perpetual interest paying, is unhealthy for farmers and society, though use of these processes may have been coincident with superabundant production.

Let us look at a few elementary facts about farmer debt:

FARM VALUES AND DEBTS IN THE UNITED STATES[1]

	1910	1920	1925	1928	1931
	(Figures in millions of dollars)				
Value of all farm property, including buildings and equipment	40,991	79,235	59,650	58,645	43,000*
Mortgage debt	3,599	7,857	9,360	9,468	9,468**
Personal and mercantile debt	1,000	3,870*	3,250		3,600*

[1] The above figures are based on United States Census estimates, except those marked by stars. The figures marked with one star are based on reports of the

Index of farm property values, including buildings and equipment

1910–1914	1917	1918	1919	1920	1925	1927	1928	1929	1930	1931 (June)
100	117	129	140	169	127	119	117	116	115	106

The same post-war downward trend in farm values, with, perhaps, some slight discrepancies, may be observed in the following figures based on the agricultural census.

Average value of all farm land in the United States per acre

1850	1890	1900	1910	1920	1925	1930	1931 Estimated
$11.14	$21.31	$19.82	$47.80	$81.52	$62.67	$48.42	$40

From all the above figures two important conclusions may be deduced: First, the American farmer went into mortgage debt mainly to buy land at higher prices. Second, up to 1920 the compensation for agricultural production was received largely in the form of increment on land values. It would be difficult to exaggerate the importance of either of these conclusions.

Not all lands rose in value from 1890 to 1920, but what was lost in some New England and southern farm lands was made up for several times over by middle and far western land appreciation. For example, between 1872 and 1900, land values in Iowa doubled. During the eight-year period from 1900 to 1908 they doubled again. And in the ten years from 1908 to 1918 they doubled once more. What does this mean for the use of credit?

A thousand dollars invested in the average Iowa farm acreage in 1900 grew to $4,000 in eighteen years. A farmer who might have borrowed and invested in Iowa land as much again as his own cash stake so invested would have seen $1,000 of his own capital grow into $7,000 within eighteen years, provided, naturally, he raised enough to live, pay taxes and interest on the borrowed $1,000, all of which would not have been

Bureau of Agricultural Economics of the United States Department of Agriculture or other Department of Agriculture sources. The figure marked with two stars is the estimate of the Secretary of Agriculture in his Report for 1930. The estimate of the value of agricultural property in 1931 is based on the June, 1931, number of *The Agricultural Situation*. This is likewise the source for the index of farm values from 1910 to date.

difficult. Transforming $1,000 into $7,000 in eighteen years makes out a pretty strong case for agricultural credit. It is not strange that, during the first two decades of this century, Iowa farmers and many others should have considered agricultural credit a beneficent institution of which farmers could never get enough. Credit was "productive."

This book emphasizes the fact that the profit in American farming since the days of the California gold rush in 1849 has consisted mainly in profit on the purchase of land. An 800 per cent appreciation in land values from 1850 to 1920, or a 400 per cent appreciation from 1850 to 1931 explains why the American people believe in Santa Claus and the productive use of credit by farmers.

Buying land in America was like buying investment trust stocks during the boom. You got no income, but you could always sell your shares for more than you paid for them. The profit on American farming was not on production but on rising land values. This rise in values was due mainly to the growth of the population from immigration and not to increased efficiency, as the believers in Santa Claus have taught. Efficiency has increased enormously since 1920, but farm land values have declined about 50 per cent. Why? Restricted immigration, mainly. It was this source of enrichment—rising land values—which enabled the American farmer to indulge the idea that he was an industrialist, a big business man, and not a peasant. The increased use of machinery and credit in agricultural production will only cumulate the ills of a peasant status with those of a factory worker.

A large part of the rise in land values between 1910 and 1920 was, of course, entirely unsound, corresponding as it did to pure inflation. What immigration had been doing for land values before the war, the printing press did for a time during the war. The influence of the credit factor must not be judged from a comparison between the volume of agricultural credit and the size of assessed land values. There was, of course, a 70 per cent increase in farm values and a 200 per cent increase in farm debt during the war. As of 1931 there appears to be a

375 per cent increase in farm debt and a decrease in farm values in comparison with the figures of 1910. The percentages just stated are significant.

Debt may, at any given time, seem small in comparison with assessed land values, approximately a third, but it must be remembered that a little credit goes a long way in inflating land values. The fact that only a fourth of the sales in a given field of property can be partly made on credit will suffice to create a purely fictitious volume of value for the other three-fourths of the sales that may be made for cash. It is what the buyer with the aid of credit can pay that determines what the buyer for cash must pay. Naturally, farmers with land to sell are great believers in the benefits of cheap and abundant credit.

War profiteering on agricultural production was an even faster process than pre-war profiteering in land values. Agricultural production between 1916 and 1920 simply could not fail to yield a profit. More money was being printed, so the farmers got more. In part this fact explains the 34-billion-dollar rise in farm values during the war. Mortgages explain it also, in part. Alongside of this imposing volume of inflated land value, the 7-billion-dollar increase in agricultural debt seemed a trifle in 1920. The trouble now is that the trifle remains while the 34-billion-dollar war enhancement in land value has completely melted away.

The explanation that agricultural credit is used for productive purposes simply is not true. The word "productive" is used in economic connections by most people without the slightest sense of what they are talking about. Gross farm income rose from 7 billion dollars in 1913 to 17 billion in 1919. The physical volume of production increased 8 per cent. Was it necessary to increase agricultural debt 7 billion dollars to increase physical production 8 per cent? The question answers itself. Farm values rose, as we have stated, from 45 billion to 79 billion dollars in the same period. This was the reason for the increase in farm debt, and the increase in farm debt was the reason for this increase in land value.

Farmers had "gone business." No one with a business mind thought that this expanded war income was merely a phenomenon of inflation which, like every other preceding war rise in prices, would be deflated as soon as the war was over. It is the sound business way to capitalize any increase in income and to assume it will go on forever, growing bigger and better. This is constructive business optimism.

In short, mortgage loans help to sustain unsound land values but do not finance increased production. The figures of the Federal Land Banks show that not 10 per cent of the money they loan on mortgage is requested for the alleged purpose of buying machinery, fertilizer, seed or productive equipment. Paying off debts and old mortgages are the alleged purpose for the use of most of the money borrowed on mortgage. Added production sometimes gives support to credit inflated land values, but unsound values do not finance added production. On the contrary, the interest charges eventually lead to a curtailment of production. As long as the increase in debt exceeds total interest charges, it goes without saying that the inflationary process will create added demand and thus finance indirectly some increase in production. But the inelasticity of the human stomach is a limiting factor.

Mortgage loans are productive for the agricultural quitter and not for the agricultural producer. It is fair to say, perhaps, that many a farmer has only received a deserved compensation for years of unprofitable toil and farm management when he has sold his farm at an enhanced price during a boom and quit farming. The obvious remark, of course, is that the payment of rewards to lucky quitters is a poor way to compensate producers. It makes compensation largely a matter of luck, determined by choosing the right time to quit.

All this, however, is passing, as we bid adieu to the war revival of the frontier drama in American life. Retired Iowa farmers are no longer trekking to sunny climes to live on their land sale booty. America is now entering upon the era of the peasant and the proletariat. The nation is growing old and becoming Europeanized. It is strangely fitting that our

first business man, champion of foreign trade and long resident abroad, to occupy the White House should be designated by a grinning Fate to lower the curtain on the frontier revival. The American farmer wanted to go business, and now he is going peasant. The American people wanted more business in government. They have had their wish. Six to eight million men are going without work. The American farmer is going to suffer because the poor chap has acquired the tastes and pretensions of a profiteering industrialist. And, worst of all, he lacks the simple folk ways which enable a man to find spiritual peace in a life of the soil.

It remains to give a somewhat extended refutation to a classical argument in favor of farm mortgages. According to this argument, the mortgage enables a prospective farmer with insufficient capital to buy outright the farm of his choice, to own it conditionally and to operate it independently, that is, as independently as a debtor can ever do anything. There is, of course, a good spiritual argument for such a loan: the borrower won't be happy without his own mortgaged farm. That spiritual argument, however, does not state a case for the soundness of the borrowing, either as a commercial venture or as a social occurrence.

What are the merits of the farm ownership argument for mortgages, on a purely commercial basis? The answer is that a farm mortgage may be a huge success in profit making or a tragic failure for the borrower. Whether it is the one or the other will depend almost entirely on factors outside the borrower's control. If a period of rising prices ensues, comparable to that which American farmers enjoyed from 1900 to 1914, when farm products rose 49 per cent in price and other commodities only 25 per cent, the mortgage borrower will be a lucky profiteer on land values. If farm commodity prices do not rise notably, but land values rise by reason of a rapid growth in population and the opening up of the country, the mortgage borrower might still be a lucky profiteer. As there was no significant use of agricultural credit before 1900, it is not safe to generalize on the probable effects of

farmer borrowing in a period of stationary or falling commodity prices but of growing population and rising land prices. One thing is proved beyond all shadow of doubt: the borrower wins in a period of rising farm commodity prices. But in such periods, the lucky farmer-gambler-with-credit is told by government officials, business men and academic economists that he is reaping the fruits of his industry and efficiency, aided by the progress of science in productive technique. The poor farmer then sells a mule, buys a Ford tractor and considers himself an industrialist.

If, on the other hand, a period of falling prices follows—such as 1812-1849, 1865-1896, or 1920-1931 and probably on into the years—the mortgage borrower will be the unhappy victim of an economic tragedy. As the present period of falling prices is the first one in our history during which we have a large volume of outstanding agricultural credit, it is unsafe to say just how much punishment the farmer can stand. It is a good deal like estimating how many straws it takes to break a camel's back. The unlucky farmer is now told by the business men and professors that he is the victim of important disturbances in world conditions. Agricultural prices have fallen from 209 in 1919 to 68 in October, 1931, while other commodity prices have fallen from 206 in 1920 to 126 in October, 1931. These are the figures of the Bureau of Agricultural Economics. They take as a base of 100 the five-year average from August, 1909, to July, 1914. To recapitulate: Over the 120 years since 1812, the borrowing American farmer would have been in luck 40 years (1849-1865 and 1896-1920) and out of luck the other eighty years when the secular trend of prices was downward.

By way of making these realities more immediate, it will now be shown just how a young man wishing at the end of 1920 to own a farm and lacking the necessary capital to pay for it outright should have proceeded. The following demonstration is based entirely on hindsight. This book makes no claim to economic foresight and challenges the claims of all who have this pretension. As Professor Dewey has observed,

we can predict an eclipse precisely because we have no control over it. We are unable to forecast future economic events precisely because we largely control them and we cannot foresee our future volitions.

Our would-be farmer should, in 1920, have put whatever money he possessed into gilt-edge bonds. Government bonds purchased in 1920 would have yielded over 5 per cent and the best railway bonds would have yielded around 7 per cent. Over the period 1920-1929, farm mortgages would have yielded 6.7 per cent for the entire United States.

As contrasted with this splendid yield for the money lenders, the average return on the net capital invested in agriculture by some 6,400,000 farmers—at any given time—about 6,289,000 at present—was about 2 per cent for the period 1920-1929. The figures now used are taken from *Crops and Markets*, July, 1929, and September, 1930, United States Department of Agriculture. In 1920-1921 the return on proprietor's capital was minus 4.2 per cent and in 1930 it was minus 1.4 per cent. In 1931 it is doubtless a much larger minus figure. It should be borne in mind that this 2 per cent annual average return on proprietor's capital over the ten years 1920-1929 is figured as an arithmetical average of the annual returns of each year on the value of the farmers' investment at the valuation of that year. The 2 per cent figure does not, therefore, take any account of the losses by depreciation in capital value, which were over 40 per cent for the ten-year period in question. This net return of 2 per cent on farm proprietor's capital is figured as the amount the farmers got for the use of their capital, after receiving an annual wage of $585 for management and labor, or a little less than that of the average farm hand. Briefly, the American farmers got an average of 2 per cent on their capital over the ten-year period and suffered a decline in the value of their investment from 47 billion dollars in 1920 to 28 billion at the end of 1929. They also got the munificent wage of $585 a year, as against $1,263 for factory workers.

The year 1930 will not be included. Its figures are appalling.

If the average farmer family in 1930 is allowed $652 as compensation for labor and management, the farm operator-proprietors suffered a return of minus 1.4 per cent. At the same time they suffered a 14.4 per cent depreciation in the value of their property; that is to say, at the beginning of 1930 their investment was worth 28 billion dollars and at the end of the year it was worth only 24 billion. The average farm hand's wage in 1930 was $535. Twenty-two per cent is added to this amount for compensation for the services of the members of the average farm family.

Let us now proceed with our supposed case of the young man who might have wanted to buy a farm in 1920. Here is what he should have done, assuming he wanted to live on the farm. (Had he wanted to work in a factory, he would have got $1,263 a year over the ten-year period, the average wage of factory workers.) He should have got a job as a farm hand, for which, over the ten-year period, he would have received on an average $595 a year, as compared with $585 received by the average American farmer-proprietor each year over the same period as the wages of management and labor.

Assume our young man at the beginning of 1920 had a capital of $5,000 and wanted to buy a $10,000 farm. He should then have loaned the farm proprietor the $5,000 at the average rate for the period, or 6.7 per cent. Of course, in 1920, he could have got a higher rate, but our supposition is entirely in terms of averages for all farmers, farm incomes, farm hands, mortgage loans, and wages over the ten-year period. At the same time our young man should have gone to work for his debtor as a farm hand at $595 a year.

Now note the results by the end of 1929. Our young man would have received ten times $335 a year interest on his $5,000 investment. At simple interest he would have thus accumulated $3,350. His boss, at simple interest, would have received ten times $100 a year (2 per cent) on his $5,000 in a farm equity. At simple interest, therefore, the boss would have accumulated $1,000, as against the $3,350 accumulated

by the lender-farm hand. Furthermore, at the end of 1929, the lender-farm hand would have had a valid claim or judgment of $5,000 on the property as against an equity, worth less than $1,000, held by the boss in the farm worth $10,000 in 1920 and less than $6,000 at the end of 1929. A 40 per cent depreciation in land value would have reduced the wealth of the boss by 80 per cent.

As a farm hand our young man, over the ten years, would have received wages equal to ten times $595 or $5,950 as compared with a reward for management and labor of $5,849 received by the boss.

In summary: On the score of earnings for labor and management, we may call it a stand-off between the farm hand and the boss, or between lender and debtor. On the score of investment, the farm-hand lender would have netted $2,350 more current yield than his boss. At the same time the lender would have conserved intact his $5,000 principal, while the borrower would have had his $5,000 capital impaired 80 per cent by the 40 per cent decline in the value of the property. The lender-farm hand at the end of 1929 would have had, at simple interest, a capital of $8,350 while the debtor-boss-proprietor would have had a capital of $2,000. The result would be made much worse by including 1930 and 1931. In 1930, let it be repeated, the average reward for labor and management of the 6 million American farmers was $425, while the average farm hand's wage was $535. The average farmer in 1930 netted minus 1.4 per cent earnings on his capital and suffered a 14.4 per cent depreciation on his principal. Does productive agricultural credit pay? Answer: Yes, it pays money lenders in a period of falling prices, and most of the years of our history have been years of falling prices.

There can be no refutation of the logic of these figures, covering all American farmers, all farm mortgages, and all farm income over a ten-year period. The logic of the average is unimpeachable. Over this period the average return on all capital invested in agriculture in the United States was 3.8 per

cent as compared with a return of 4.7 per cent for all capital invested in industry. Borrowing money at 6.7 per cent on mortgage and at a higher rate on personal credit, to put into a business paying less than 4 per cent explains why American farmers have had to work for half the pay of a factory hand and take a 2 per cent return on their investment, as well as suffer a 50 per cent depreciation in their capital. To state that many debtor farmers have prospered during this period is beside the point. For those who have beaten the game there are far more who have received considerably less than the average figures shown above.

Parenthetically, the French state mortgage banks supply abundant capital for French peasants on mortgage at 3 per cent and on short term at 4½ per cent. With French mortgage rates and American earnings, American farmers might have borrowed profitably, provided they had not overused such credit to depress still further the yield on agricultural investments from its present level of around 4 per cent. American mortgage loan rates, however, could not be reduced to the French level, for two reasons. First, the expenses of dispensing credit must be higher in our large territory than in France. Second, the American farmer has not the good sense and modest ambitions of a French peasant to use credit sparingly, or little except for emergencies.

The answer to the question, Should farmers borrow? is identically the same as the answer to the question, Should one buy stocks on margin? The answer is Yes, if the market is rising, and No, if the market is falling. If one is a realist, one does not know whether prices are going up or down during the future period of repayment. Consequently, the advice of most realists to farmers about to borrow will be that of Mr. Punch to persons about to marry.

Incalculable mischief has been done by the misleading of farmers as to the gambling nature of borrowing during the period of rising land prices. The farmer has been led to believe that borrowing is a peculiarly virtuous operation because

it is business-like. It is assumed that the borrower is judicious and industrious. The farmer is both. Curiously enough, the duller a man's wits, the higher is the opinion he holds of his own judgment. Life offers few more pathetic sights than that of a stupid man judiciously playing against a percentage game.

CHAPTER XI

SHORT TERM CREDIT: FINANCING INCOMPETENCE

BESIDES long term farm debt, there are two classes of agricultural credit called, respectively, intermediate credit, extending from nine months to three years, and short term credit, running not more than nine months. The importance of short term credit as a factor tending to stimulate overproduction and to enforce a low standard of living among farmers makes this subject seem worthy of special attention.

A case against short term and intermediate borrowing by farmers, except as an emergency measure, will be developed on the basis of the following three propositions: First, farmers, being poor people, should save for their old age and dependents. Second, they can find no better use for their savings than in constituting and holding available for their use an adequate working capital. Third, all persons not capable of operating farms on their own capital should be eliminated as farm proprietors and operators by the simple enforcement of humane usury laws, which would invalidate all loans or claims, in any form whatsoever, involving an interest rate in excess of 6 per cent.

Short term loans to agriculturists do not, as is commonly believed, finance or even aid production, except during that short period in which their total volume is expanding. If the total volume of short term credit is increased during a given year, the increase may be connected with increased production of agricultural goods. It may also be connected with the fact that many farmers could not pay interest on existing debts and taxes, or meet installments on automobiles and radios or live as well as they wished if, in that particular year, they did no borrowing. If the volume of short term credit remains comparatively unchanged, as it must over most of the time, there

is no financing of anything except the incapacity of several millions of farmers to budget expenditures, manage properly their finances and save up a working capital.

It is obvious that, were most short term agricultural credit, in its manifold forms, suddenly to be cut off by the enforcement of proper usury laws and by cash mercantile sales, there would result a curtailment in production and, possibly, some hardship to many habitual borrowers, while they were giving up farm operation for their own good as well as that of society. If, however, these short term borrowers were suddenly or slowly forced out of business in large numbers, it is evident that agricultural production would be reorganized in more capable hands and would promptly adjust itself to current demand, but at a higher level of prices, corresponding to the superior bargaining power of less impecunious producers. The curtailment in production, caused by the elimination of slave labor, would necessarily raise prices and real earnings to rates attractive to free labor. This would make agriculture comparably remunerative with many other lines of production like banking and beauty parlors. Agriculture would be entered by persons capable of maintaining a proper reserve of working capital.

Realistically viewed, all crop loans to farmers, or extensions of mercantile credit, are little or no different from bimonthly loans to an employee who is always broke a few days after pay day, except that, in the latter case, no interest is usually charged this public nuisance. Consequently, the friendly lenders have not had, for their conscience' sake, to weave an elaborate network of fallacies about the productivity of these troublesome loans.

It will be at once objected that the foregoing brief critique of the use of short term agricultural credit challenges certain venerable credit institutions and ways of long standing and wide acceptance. It will be added that producers in nearly every field have been in the habit of borrowing money for seasonal needs and repaying it when the needs have passed. This practice, obviously, avoids the necessity of keeping avail-

able all of the time large amounts of working capital for use some of the time. The old theory has been that it is cheaper to hire money from others when it is needed and pay full earnings to stockholders than to withhold a sufficient amount of cash for seasonal needs and hire it out to others when not needed.

It is impossible to discuss adequately in brief space the pros and cons of this theory. It has already been shown to be largely fallacious under modern conditions, due to the dynamic nature of economic events. The argument for seasonal borrowing, of course, assumes that the proprietors of the borrowing enterprise can find a highly profitable and safe use for their capital the year round and that there is no serious risk to borrowing seasonally. That both of these assumptions are usually unfounded needs little proving. To most people their fallacy will be apparent at a glance.

The case against non-emergency uses by farmers of short term credit may best be developed by stating and attempting to answer the following two questions: First, should a farmer keep his savings permanently invested in some one else's business at a low interest return and borrow perpetually at a high interest rate to finance his own business? Second, should a man who cannot save enough to supply his current needs in working capital be a farm operator at all?

Let us now proceed to develop the answers upheld by this book. In the first place, the farmer who saves money should use his savings for working capital and keep them, when idle, on deposit in a good bank, which will, most likely, be a large institution in a large and, possibly, distant city. The farmer will never in the long run be able to invest his savings more advantageously than in avoiding recourse to lenders. Farm short term loan rates in 1923 averaged over 9 per cent in 11 states of the union; 8 per cent in 13 states; 7 per cent in 6 states; and 6 per cent in the other 18 states. Today these rates are only slightly lower. Need it be shown that a farmer who has to be borrowing around nine months a year cannot pos-

sibly find it to his advantage to invest his savings at 3 to 6 per cent and borrow at 6 to 14 per cent?

Mistaken ideas about credit held by farmers who save money contribute largely to one of the greatest curses of American agriculture—the small country bank. This institution, with a paid-in capital between $5,000 and $50,000 and with deposits ranging between $50,000 and $500,000, has been the focal point of over 6,000 bank failures in twelve years, involving the loss of nearly 2 billion dollars. These banks have not capital and deposits enough, even if loaned out all the time, to earn a fair return on stockholders' capital and pay the necessary expenses of operation, which, naturally, include some interest to depositors.

It is difficult to run any bank with annual overhead expenses of less than $6,000. The salaries of a manager, cashier and janitor, not to mention rent, heat, light and stationery, will exceed $6,000 a year. A bank with a capital of $10,000 and deposits of $100,000 must keep approximately 10 per cent of its funds idle in cash reserves. If it keeps $100,000 loaned out the year round at 9 per cent, which would be nearly impossible, it will realize enough to pay $6,000 for expenses, plus a return of 8 per cent on the $10,000 capital and of 2 per cent on the $100,000 of deposits. The reserve for losses and taxes will, of course, absorb a good part of the 8 per cent gross return on stockholders' capital.

It is self-evident that expenses are the largest item of the 9 per cent interest charged borrowing farmers. It is equally clear that there is no way of operating a $100,000 bank without charging 9 per cent interest, unless the operating expenses are paid by a philanthropist. Professor Virgil P. Lee shows clearly in his *Principles of Agricultural Credit* that the high rates of interest paid by farmers in the Middle West and in the South are not due to a scarcity of capital nor yet to a notably higher percentage of losses than characterize banking in New England, where interest rates are lowest. Interest rates from 8 to 14 per cent in twenty-four states are due mainly to

the high expenses of operating small credit dispensing units. It is the variation between operating expenses and not between losses that accounts principally for the variation between interest rates charged farmers in Texas and New York. Small banks simply must charge high interest rates to cover expenses.

Responsibility for the small country bank evil lies partly at the door of the farmer who saves capital and wishes to make a large profit by lending it at high rates of interest. Those who teach the belief that borrowing is productive for poor farmers are, perhaps, most responsible for these unhappy conditions. The farmer capitalist and the merchant capitalist may, as a lender, profit from 10 per cent interest rates. But both, in the long run, suffer from low prices caused by slave labor production of agricultural commodities.

In the second place, the answer to the question whether chronic borrowers should be farm operators is a rotund negative. There is no danger of underproduction of farm commodities. Society needs the farmer's welfare. The business profit maker needs the farmer's buying power. Both are undermined by every cent of interest the borrowing farmer has to pay.

It might be possible, though it is not likely, that agricultural credit could be cheapened somewhat by group banking. But anything gained from such cheaper credit would accrue entirely to landlords and others than agricultural producers. Commodity prices would fall. The farmer's share of what he produces would not be raised—could not be raised—by cheaper credit. It will be explained in the next chapter why the cheapening of production costs has never helped the farmer and why it cannot help him.

In conclusion, there can be no credit solution of the agricultural problem. The payment of interest by farmers effects a maldistribution of farm income and inevitably leads to the depression of agricultural prices to the detriment of farmer welfare as well as of general trade. Experience and theory indicate that it is absolutely indispensable to the economic and moral health of any nation, according to prevailing standards,

that its agricultural production be carried on by proprietors operating with proprietors' capital, and not by tenants, serfs or debt slaves working for an absentee capitalist. And there is nothing in the foregoing proposition in conflict with sound capitalism.

CHAPTER XII

PRODUCING OR BARGAINING POWER

NOT only is the farmer the victim of the credit fallacy, but he has suffered greatly from weird delusions about production. These delusions may be summarized under two heads: The first may be traced to the sinister influence on social thought of a kindly old English clergyman named Malthus. This is the delusion that society needs as much additional agricultural production as fresh extensions of credit and improvements in productive efficiency can bring about. The second delusion derives from the first. It is the notion that cheaper and more abundant agricultural production, being urgently needed by society, will benefit the farmer. An attempt will now be made to point out the fallacies of these beliefs.

The fact that the farmer is confronted only by a problem in bargaining and not in production is rarely understood by his friends. Increased production, as this chapter attempts to show, does not ordinarily strengthen the producer's bargaining power. On the contrary, it usually weakens it.

As a basis for the discussion, a few statistical facts will be stated in two footnotes. These data show rather conclusively certain measures of the disparity between the farmer's economic return and that of other producers. The growth of agricultural productivity was shown in Chapter IX and the growth of agricultural debt in Chapter X. This chapter shows and interprets the result; namely, the increased economic degradation of the farmer.

The first footnote[1] reproduces a table from *The Agricultural Problem in the United States*, published by the National Industrial Conference Board in 1928. The table divides the working population of the United States into five groups: agriculture,

[1] *Agricultural Problem in the United States*, page 47.

manufacturing, mining, transportation, and miscellaneous other pursuits. From these figures it appears that it took a much maligned war to work out a nearly fair distribution of the national income among the five groups of producers just mentioned. Thus in 1918, the farmers, then constituting 21 per cent of the working population, received 20 per cent of the income, while the members of the miscellaneous group, constituting 37.86 per cent of the working population received but 38.34 per cent of the booty. By 1921, the same 21 per cent of the working population, the farmers, were receiving but 10 per cent of the income, while the 37 per cent in the miscellaneous group were getting away with 52 per cent of the income.

The disparity between the farmer's economic status and that of other producers may be expressed in innumerable types of measurement of wealth and income. One of the most valid and effective methods of presenting the fact of this disparity is to show the decline in the purchasing power of the farmer's output since 1910. Accordingly, the second footnote[2] shows three indices, prepared by the United States Bureau of Agricultural Economics, and taking a five-year average from August, 1909, to July, 1914. These indices represent: No. 1, the prices received by farmers for farm products; No. 2, prices paid by farmers for non-farm goods bought by them; and No. 3, the

TOTAL WORKING POPULATION

	Agriculture	Manufacturing	Mining	Transportation	Miscellaneous
1909	25.67%	28.79%	3.27%	7.46%	34.81%
1913	23.70	28.18	3.21	7.69	37.27
1918	21.41	30.10	2.84	7.79	37.86
1919	22.06	31.43	2.97	8.12	35.42
1921	21.70	28.89	3.06	8.63	37.72

SHARE OF TOTAL INCOME RECEIVED

	Agriculture	Manufacturing	Mining	Transportation	Miscellaneous
1909	16.29%	28.04%	3.14%	9.60%	42.93%
1913	16.54	27.11	3.35	9.38	43.62
1918	21.01	28.65	3.33	8.67	38.34
1919	18.33	26.82	3.18	8.58	43.09
1921	10.56	24.07	3.04	9.78	52.55

[2] *The Agricultural Situation,* August, 1931, page 19, United States Department of Agriculture. Crops and markets, November, 1931, page 495.

GENERAL TREND. PRICES AND PURCHASING POWER

Five-year base August, 1909, to July, 1914=100

	Index No. 1 All Farm Prices	Index No. 2 Prices Paid by Farmers	Index No. 3 Per Cent Received to Prices Paid
1910	103	98	106
1914	102	101	101
1917	176	150	118
1918	200	178	112
1919	209	205	102
1920	205	206	99
1921	116	156	75
1925	147	159	92
1928	139	156	90
1929	138	155	89
1930	117	146	80
1931 January	94	137	69
" March	91	134	68
" May	86	131	66
" July	79	129	61
" August	75	127	59
" September	72	127	56
" October	68	126	54

ratio of prices received by farmers to prices paid by them. When the figure of the third index is under 100, the farmer is doing worse than in the 1909-1914 period. In 1917 this figure stood at its peak of 118. By October, 1931, it had declined to 54.

In October, 1931, the index of farm prices was 68, while that of prices paid by farmers was 126, thus making the ratio 54. What does this mean for farmer welfare and trade? It means that roughly 27,400,000 people living on farms today are able to buy 54 cents' worth of goods where they should be buying $1 worth of goods with their production. It means that the American farmer is becoming a peasant, or, perhaps, better said, a debt serf.

Cheap goods are a snare and a delusion of business men and classical economists. In a nation like the United States capable of producing over 90 per cent of its commodities, the money cost of goods is, of itself, unimportant. The economic cost of goods is also not important. What is important is that prices should be in such a state of balance between all goods as

to allow of a desirably large volume of production and trade. The country does not need cheap farm goods. It needs prosperous buyers among the 27,000,000 farm dwellers.

The facts of increased productive efficiency and increased economic degradation in agriculture remain proved. Let us develop some further interpretation of these phenomena. It may be said that if farmers further increase production, world production and demand remaining relatively unchanged, they will only reduce their aggregate purchasing power. In other words, the more farmers produce, the less they will receive of the national income, other conditions not developing some unusually favorable turn for farmers. This is a necessary phenomenon of the behavior of the capitalistic price system.

What is the present situation of the farmer? If farmers as a whole increase production, they automatically decrease their aggregate income. If an individual farmer reduces his own production, he immediately receives a lower money income. For debtors a lower money income nowadays means foreclosure and eviction, or a loss of home and job. The individual debtor farmer is between the devil of the creditor and the deep sea of overproduction. Naturally the whole army of debtors are running headlong into the sea. Now it is a lot easier to exorcise the devil of the creditor than it is to do anything about the deep blue sea of overproduction. To this problem we shall return later.

We have not finished with the fallacious belief that society needs more food and raw materials. It seems pointless to ridicule Malthus, who could not foresee the application of modern technology to agricultural production or the widespread practice of birth control or the cult of thinness. We shall not, however, be as lenient with the reactions of the shopkeeper's mentality to temporarily high prices.

A world shortage of only 10 per cent, caused by war and aggravated by a number of serious disturbances in the systems of marketing and transportation, may double or even treble prices, if government fails to rise adequately to the situation. For instance, world production of wheat in 1916-1917 dropped

20 per cent below the 1910-1914 average, while the farm price of wheat in America rose 175 per cent and the retail price rose 100 per cent. World wheat production rose in 1920 to the 1910-1914 level and averaged 20 per cent above that level from 1922 to 1928 when it rose to 30 per cent above the pre-war level. (The consumption of wheat flour per capita in the United States was 223.9 pounds in 1889 and 175.2 pounds in 1929.)

The moral of this is that only a few months of peace are needed to correct a war-caused shortage in production. It was not necessary to expand the world's agricultural producing plant 50 per cent because prices went up 150 per cent. But there is no use expecting a business man to see it this way when prices are up 150 per cent. As it happened, of course, the farmer's burden of war and immediately post-war debt was not incurred to finance additional production, but to pay inflated land values or to indulge extravagant tastes on credit, in the belief that his land was worth more than it is when he comes to repay those debts.

There is a further point to be stressed. High prices during a period of temporary curtailment of production do not reflect the extent of the shortage, which is only slight. High prices indicate the effectiveness of speculation in cornering the market by the use of abundant credit. Once speculators can count on a 20 per cent curtailment of production for a year or two, they can, at once, with impunity, buy up the entire output, 90 per cent on credit. They can then create the same effect on prices as might result from a 90 per cent reduction of supply. The results of the situation so caused are an inflation of land values and the advice of Mr. Lodge to the American farmer to produce more as late as June, 1920. History proves the utter impossibility of controlling the uses to which credit is put. The evils of speculation on credit can be minimized in only one way, namely, in measure as the total volume of credit is absolutely restricted or contracted. The credit teachings of our endowed business schools and subsidized economists can be qualified as largely fallacious. Recent events in our security

speculative orgy have furnished additional proof that there can be no scientific management of credit. Credit is a gambler's institution, the evils of which can be combated only by quantitative restriction.

The business way of meeting any temporary shortage and high prices is a speculative spree on credit. The humane way is to determine needs and ration the available supply at a fair price. Exports of any surplus may be made at world prices, if the price can be received without foreign lending. The excess price will be retained by the state and distributed by it among all producers or otherwise disposed of in a proper manner.

The domestic price of wheat in the United States should have been kept below $1.50 a bushel, and other prices in relation by a proper restriction of credit. But that would have precluded selling 16 billion dollars' worth of war supplies to foreigners for I.O.U.'s which will never be paid. And that is another story to be discussed in later chapters on foreign investments.

The farmer has been the peculiar victim of agricultural high prices created by speculative uses of credit. Let us proceed to examine the mechanics by which he pays for the error of agricultural overproduction induced by speculative inflation of prices.

More than one hundred fifty years ago Adam Smith observed: "Scarce any nation has dealt equitably with every sort of industry. Since the downfall of the Roman Empire the policy of Europe has been more favorable to arts, manufactures, and commerce, the industry of the towns than to agriculture, the industry of the country." It would, however, be somewhat wide of the mark to say that in this country during the past fifteen or twenty years discrimination against the farmer has been a policy of deliberate design. The farmer has fared badly, as this book makes an effort to show, mainly because his financial and productive policies have been based on fallacies. It may be fair to Adam Smith to add that there may have been method in the teaching by business men and their subsidized statesmen and economists of this madness to farmers. But it

proves to have been a poor method for the best interests of business, though it may favor the *rentier* class.

Now in the mechanics of the business system, increased productive efficiency in a given field of production is likely to be punished by a lower reward, unless monopoly power is obtained and successfully exercised. It needs no explanation that monopoly power can never be obtained by farmers in an industrial nation. The only way for farmers to wrest from a reluctant world a better price is to curtail production.

In the theory of the economic books, the producer does curtail his output after a sufficient period of undercompensation. In fact, as the Bureau of Agricultural Economics states in the January 1, 1931, number of the *Agricultural Situation*, "A striking thing in the face of the past year and of the many hard years since 1920 has been the stability of agricultural production."

Now the chief objective of the remainder of this chapter is to explain why the farmer ought to have curtailed production and why, practically, he could not do so. It is silly to counsel curtailment of production to individuals, though it is the only course which can benefit their class, if curtailment of production means economic suicide for the individual. That fount of business and agricultural wisdom, the Federal Farm Board, published in November, 1930, a pamphlet, entitled "Grow less; Get more." This was excellent advice for a collectivity, but the farmer who grows less at once gets less money. If he is a debtor, he also gets evicted.

A farmer has a fixed plant, fixed tax charges, and in cases of mortgage debtors, fixed interest charges. In himself and family he has a fixed labor supply which cannot be turned to the production of other saleable goods. If he curtails production, all of his fixed charges go on; he economizes practically nothing; his plant lies idle, wearing and rusting out; and his immediate money income is reduced. No matter how unremunerative prices may be, the farmer saves little by curtailing production and loses the market price of such crops as he might, but does not, produce. It follows then, as day the night,

that, for the farmer who hires no outside labor, it is always preferable to produce more and so help to make prices go lower, unless the farmer is free of debt and in a position to turn his productive plant and labor to the production of a larger quantity of goods and services for his own consumption.

The farmer's problem is one of bargaining, not producing. In order to solve his bargaining problem, he needs to curtail production. To curtail production, he needs to develop greater self-sufficiency and independence of trade. For this achievement, he needs a reduction of fixed charges, the principal one of which is interest. A solution for this problem will be discussed in the concluding chapter on agriculture.

To sum up: one of the principal obstacles to a rational curtailment of agricultural production in the face of falling prices is agricultural debt. Over half the farmers are in debt. In 1930 the six-odd million farm operators received for their capital, labor and management 3,750 million dollars, or for their capital and management alone minus 346 million. At the same time they paid in interest to non-operators 671 million and in taxes 777 million. The renters paid 701 million in rent. The important fact is that interest was approximately the same in 1930 as during the six preceding years, 1924-1929, but the eturn of operators for capital, labor and management was billion less. The point is that for the farmer bankruptcy neans loss of home, job and further credit. Consequently, he oes on producing and paying interest as long as possible.

Now, it may be said that debt-free farmers contribute to verproduction more than debtor farmers, which is true. The ebt-free farmers have lower production costs than the debtors nd will normally outlast them in a period of falling prices. he point here is the following: A curtailment of production uring a period of falling prices must always begin among the eakest or least efficient producers. In industry, this always appens promptly, since the employees of a weak company will ot work for half the current wage scale merely to keep that mpany out of bankruptcy. In agriculture, however, the weakt producers, the debtors, will go on working for a bare sus-

tenance and producing the more frantically as prices fall, all by way of saving their homes and jobs. Were they debt free, they would naturally curtail production as it became unprofitable. They would produce enough to pay taxes and provide the bare necessities, but curtail their consumptions of town goods.

The considerations just developed indicate that the farmer's mistake has not really been the use of bad business judgment, but the use of any kind of business judgment. Farm mortgages, land purchases at inflated values and increases in production were all judicious business acts. In moments of emotional optimism business men will always act in disregard of the lessons of experience and theory. Price data for the past century, available in any public library, might just as well have been locked away in the subconscious mind of the Grand Lama of Tibet, for all the influence they have had over American business men since the war.

The business man always says that he is not in business for his health. That, however, should be just the reason why the farmer is in farming. Spiritual and physical health is about all he can expect to get out of farming in the long run, once the period of land profiteering on the settlement of a new continent has definitely closed.

Farmers are devotees of an ancient and honorable cult; they should not try to be business men. This cult is one of the healthiest and finest factors in the life of any nation. Any intelligent person who respects, and wishes to protect the cult and its votaries will tell them of the unwisdom and dangers inherent in any practice by them of business ways. Security and spiritual peace must be the rewards of this cult—not the illusions of business optimism.

The farmer has no right to bet his home and job on a risk-taking venture like a mortgage—not any more than a clerk has a right to bet a week's pay on a sure-thing tip in a horse race. There are long periods, such as the present, during which it is much easier to pick a winner in a horse race than a profit-making use of money.

Business enterprises employ capital when and as it seems profitable. Business men have neither a moral duty nor a legal obligation to assure a steady return on capital or a steady job to labor. And, as a matter of fact, they most certainly do not. What is more, no one can show in theory how business ever can assure a steady income to the capitalist or a steady job to the worker. If these achievements are to be approximately realized in a capitalistic society, it must be done by government regulation and taxation.

Farming is essential to the survival of capitalism because farming is the one important field of enterprise in which the capitalist may, without state intervention, assure himself a regular income and a steady job, if he does not borrow and if he diversifies crops. The state, however, must help him out of debt.

It is only fair to say that business is organized in corporate units or partnerships for collective risk taking. The business man who optimistically takes big risks with other people's money and, sometimes, with a little of his own, may have any number of ventures fail. Stockholders, bondholders and even banks take their losses, put up new capital, smile and hope for the best. When the farmer gambles and loses, his creditors hold him to the last cent of repayment. He must reduce his standard of living as far as he can and eventually lose his home and job if the sacrifices become too much for him. New corporate entities can be spawned like frogs in a pond. New farmers take a generation to form. Optimism is the business man's game when he is managing other people's money. They seem to like it. The cult of the soil must be 100 per cent realistic. In measure as farmers aim at security and self-sufficiency rather than profits, avoiding debt and diversifying their production, they will increase their bargaining power in trade with the town. The farmer cannot beat the business game. Fortunately, he does not need to play it.

CHAPTER XIII

WHAT NOT TO DO FOR THE FARMER

THE history of farm policies is largely the story of what not to do for the welfare of farmers. Any constructive discussion of the agricultural problem must give consideration to these errors, not for the germs of any useful ideas they contain, but mainly for the unfortunate influence they exert on public thinking. Seven panaceas will be discussed briefly. They all have one common idea: they propose to help the farmer to make money.

The contention of this book is that the farmer's principal need is for protection, particularly against attempts at making money. The argument is that the farmer can only be helped by policies which increase his independence and ability to live happily on the land. Incidentally, such policies will enhance his bargaining power in trade. Aids to money making always lead to more production, and that is the one thing of which the farmer has had too much.

1. Improved marketing facilities, or the elimination of the middleman, will always fascinate the farmer and his friends. It is kind of them to be so anxious to help consumers obtain food and raw materials at low cost, but naïve of them to suppose that any achievement in this direction would benefit the farmer in the slightest. It is perfectly obvious that the farmer has always received a relatively small proportion of the retail price of his product, and that his share has tended rather to decline as the complexities of marketing and retail service have grown. These facts, however, have no such sinister significance for the farmer as he has been led to imagine. They merely indicate that it costs more to transport, distribute, advertise and give service nowadays than it did formerly. These facts seem to call for neither wonder nor indignation. These costs can be eliminated or materially reduced only by the

abandonment of our present manner of life, a change which would, in no apparent way, increase the farmer's share of the national income.

Distribution and marketing must be done agreeably to present needs and tastes. The business is open to anyone. The farmers, either through cooperatives or ordinary companies, can, as in some instances they have done, undertake to render these services. Whether the farmers can beat the middlemen at their game seems open to some doubt. Be that as it may, the farmers should realize that if, by any chance, they could reduce the present costs of distribution of farm products to consumers, the resulting economies would benefit entirely the consumers and not the farmers.

The farmers could not extract one cent more from the consumer than at present, were they always to meet him face to face in the open market. This is true, not because the consumer could not be made to pay more for farm products, nor yet because the costs of marketing might not be further lowered. The fact is that farmers selling directly or through their agents to consumers would glut the market just as surely as they do when selling to middlemen. Probably the middlemen have helped farmers by discouraging the offer of an oversupply, an interest which middlemen have and which consumers would most certainly not have.

In brief, marketing or distribution of farm products is not the farmer's vocation. His fight with his customers for better prices must be fought on the farm by curtailing production. This he can achieve only by deriving more satisfaction from his own farm and depending less on trade. Only in this way can he force the town to offer him a better price in the town's goods.

2. Many agricultural economists who worship at the shrine of productive efficiency have advanced the suggestion of large scale farm corporations to grind out farm products like Ford cars. Mr. Brookings and Mr. Ford have sponsored the large scale farm corporation idea. Mr. Thomas Campbell, after a million dollar failure, has for a short time successfully operated

a 95,000 acre wheat farm at Hardin, Montana, producing 500,000 bushels of wheat a year. His income statement since wheat has been selling in the fifties had not been published when this book went to press. Mr. Ford has conducted a similar agricultural corporation experiment at Dearborn, Michigan.

On this subject Mr. Ford says in his *Today and Tomorrow* (1926), pages 141, 142: "The moment the farmer considers himself as an industrialist with a horror of waste, either in material or in men, then we are going to have farm products so low priced that all will have enough to eat and the profits will be so satisfactory that farming will be considered as among the least hazardous and most profitable of occupations." That the farmer has had a due horror of waste may be questioned by some minds. But surely Mr. Ford does not find farm products too high priced or scarce today. Still the unemployed are more numerous than ever and there are more people going hungry in the United States. At the same time Mr. Ford's profits are declining and he is reducing operations. Mr. Ford preached the elimination of waste in agriculture and cheap farm products. Now the experts favor destroying crops and plowing under every third row of cotton.

All the farmer need do to destroy himself and the country with him is to listen attentively to the counsels of business men. Perhaps all that need be said by way of comment on large scale corporate farming is expressed in the remark of Professor James E. Boyle that such corporations might be divided into two classes: those that had failed and those that would fail. The agricultural problem remains through the ages the same, not one of producing goods cheaply, but of enabling people to live happily on the land.

3. The tariff is an especially fertile field of agricultural remedies. Farmers and their friends differ greatly in their tariff views, but they all agree that the farmer has not been getting his share of the tariff booty. Some think that equality should be established by giving the farmer a bigger slice of the tariff pie and others hold that equality would best be achieved by giving no one any tariff pie. The pie distributing school of

thought, however, seems to have the farmer's collective preference, as he votes regularly the Republican ticket. As the tariff is discussed in succeeding chapters, only brief consideration will be given to it in connection with the farmer.

It is clear that government subsidies to one group of producers must be paid for by other groups and that, so far as tariffs are concerned, the farmers are always on the paying end. But this is almost equally true in respect of naval appropriations. The manufacturers get the larger part of the orders and profits. Supposedly, a large fleet protects the nation, and, supposedly, a tariff does the same thing for the nation's industries. There is perhaps just as much reason for a tariff as there is for a navy. This book does not deny the need for either. The farmer must bear a large share of the burden of industrial as well as of national defense. Some one has to pay for industrialism as well as for imperialism.

The farmer should further understand that industry is a more delicate institution than agriculture. The lean and heavy-laden are always stronger than the bloated. Industry has to be bottle fed in every country where it is allowed to become a predominating factor. The romance of the growth of modern industry is the romance of bottle feeding. The bigger the creature grows, the more it needs the bottle, and the more disastrous to society would be any attempt at weaning. The only feasible way of weaning the creature is gradual deindustrialization and a return to the land.

The farmer is the strength of any nation precisely because he is not pap fed and can live without the bottle, that is, until he becomes businesslike. Then he joins the bread line in hard times—in business America but not in peasant France.

4. Exports of an agricultural surplus through American investments abroad is a popular farmer panacea. It need only be pointed out here that no country has ever expanded agricultural production by making foreign loans. The process has always been the other way round. Exports of manufactured goods have been made on credit with a view to receiving interest in agricultural and raw material imports. It is ridiculous to think of

promoting both industrial and agricultural exports by means of foreign loans.

In the forties England chose to promote industry and cripple agriculture, a decision which sealed the eventual doom of the British nation. It is at last coming to fruition. The idea of promoting agricultural exports by foreign loans does not merit a refutation. It is a brand of foreign trade folly which has never even been put into practice.

5. As for federal or quasi-public institutions of agricultural credit assistance, little need be said in addition to the general discussion of agricultural credit already developed. There is the Federal Land Bank system of the ten land banks, created in 1917 to loan money on farm mortgages, payable on the amortization plan within five to forty years. It has some 1,188 million dollars loaned on mortgages out of a total of 9,450 million invested in this form of agricultural credit. These banks make only highly conservative loans at rates of interest around 5 per cent, obtaining funds for this purpose from the sale to investors of bonds bearing a lower rate of interest and enjoying a special tax exemption feature. This feature constitutes a subsidy to agricultural borrowers of the most prosperous class, who least need government aid.

There is also the Intermediate Credit Bank System of 1923, competing with commercial banks in the making of loans running from six months to three years. There is no real need for either federal credit institution. Their clients could always obtain accommodation elsewhere. Their facilities do nothing to relieve the real sufferers in agriculture or to correct any of its evils. These institutions merely give credit facilities to the most eligible of agricultural borrowers.

6. Schemes for tinkering with prices and controlling surpluses have always had a peculiar appeal to the farmer and his friends. The follies of the Agricultural Marketing Act of June 15, 1929, and its creature, the Federal Farm Board, can be given only brief attention. The law authorized the appropriation of a $500,000,000 revolving fund from the federal treasury to be advanced to a series of cooperative marketing associa-

tions and stabilization corporations by a Federal Farm Board to supplement the credit facilities of the existing institutions already mentioned.

The specific objectives of this nexus of vicious federal or quasi-public institutions were: to minimize speculation; to prevent inefficient and wasteful methods of distribution; to assist the orderly marketing of farm products, and to control agricultural surpluses. The Board announced that it had the following three aims in its endeavors to assist the farmers: (1) to help the farmers organize into cooperative market associations; (2) to aid in federating these associations into districts or regular selling units; and (3) to assist through loans in developing efficient merchandising organizations.

The assumptions on which this well-meaning legislation was based may be pronounced fundamentally unsound in every important respect. The personnel of the Board is composed of ten men of wide business and agricultural experience. Their business judgments have been about as far wrong as it seems possible for them to have been. Operating "to minimize speculation," these business experts have legally speculated with several hundred million dollars of the people's money, most of which they have lost. In the short run of two years they have met the fate which, sooner or later, must befall all speculators, if mathematics be an exact science.

At prices prevailing on October 31, 1931, the exercise of sound business judgment by ten business experts, selected by a business President, according to the statement of Chairman Stone before the Senate Committee on Agriculture, had cost the American taxpayer about 177 million dollars: 102 million on 189 million bushels of wheat and 75 million on 1,300,000 bales of cotton. It is believed that these figures grossly understate the losses, but it seems hardly worth while to go into a question of 50 million dollars more or less on such operations. In addition, the unfortunate cooperatives, which were begotten and assisted by the Farm Board and its experts, stood to lose another 110 million dollars on 2,000,000 bales of cotton. For their services in thus losing money, it appears that officials

employed by the organizations engaged in these gambling operations received salaries running up to $50,000 a year. If there is a bigger business blunder than that of buying and holding a commodity on a falling market and then selling it when the market has touched bottom, whoever discovers that blunder will have surpassed the record now held by the business experts of the Federal Farm Board. And the commission of the blunder has not helped the farmers.

The trouble with all these federal agencies for farm relief, as with all the panaceas, is that they have been conceived and operated with business ideas. They have aimed to help the farmer make money. The closing remarks of Mr. Hoover's, on July 15, 1929, to the ten business experts, as they assumed their duties on the Farm Board, betray exactly what is wrong with the institution. Mr. Hoover said, "I invest you with responsibility, authority and resources such as have never before been conferred by our Government in assistance to any industry."

The whole explanation of this tragi-comedy is in the last word of Mr. Hoover's remarks—"industry." It is the farmer as an individual, a human being, a babe in the woods of business, who has needed the paternal guidance and protection of a humane government, concerned over enabling him to make for himself a better life on the soil. There has never been anything wrong with the agricultural industry. It has been paying during the past five years 6½ per cent to lenders on mortgage and a little over 7 per cent to landlords renting farms. It has furnished a superabundance of cheap products. It is both efficient and overproductive. It has had too much credit, too large foreign markets and too much business. It is the farmer who has fallen among business men and been reduced to a position in 1930 a little above that of a serf, having an income of $425 for labor, management and return on capital. (These are the figures for the average of 6,289,000 American farm operators having on January 1, 1930, an investment worth 28,177 million dollars and on January 1, 1931, an investment worth 24,132 million.)[1] Mr. Hoover thought of assisting the

[1] *Crops and Markets*, September, 1931, page 399.

industry. It is the farmer who needed assistance. A man working for $685 a year in 1929 and $425 in 1930 is not an industrialist. He is a debt serf.

It seems not to have been realized that money making neither can nor ought to be the object of government assistance. The idea, for instance, that the total value of a cotton crop can be raised by carrying over a part of the supply from a large crop year to a small crop year has been proved by theory and recent experience to be completely erroneous. The way to raise the total value of a cotton crop is to buy up a part of the crop in a short crop year and thus to force prices to even more absurd heights than they would otherwise attain, and then, during the next large crop year, to sell the part so bought and held.

The good profiteering of a year of scarcity should never be spoiled by selling goods held over from a year of plenty. The total return to cotton growers will be higher in a series of big and small crop years than in a series of years of stabilized production and prices. Stable supply, demand and prices do not, in most crops, yield maximum profits to producers. It is only profitable to pay interest on borrowed money for the manipulation of surpluses and prices in ways which exploit scarcity, and not in ways which insure evenness of price level. Those who may be interested in the theoretical and historical demonstration of these unpalatable truths, somewhat loosely stated for the purpose of easy grasp by a non-technical public, will find it in Messrs. Stodyk and West's book on the *Farm Board* or in Professor Black's book on *Agricultural Reform.*

The simple truth is that the ways of making money by control of prices, supply and demand are the ways of a rascal. An elementary knowledge of English common law would suffice to vouchsafe this piece of information. Obviously, when the government sets out to help a class of citizens to make money by market operations to control supply, demand and prices, it cannot well use the ways of a rascal. It will, therefore, use the ways of a fool and fail to make money for anybody. It will, however, lose money for the taxpayer. The Farm Board advanced money to the Stabilization Corporation to buy

wheat and at the same time advised growers in 1930 to reduce plantings of spring wheat by 10 per cent. The farmers wanted government aid to make money and the government undertook with the assistance of business exports to give such aid. The results speak for themselves.

7. The last agricultural panacea is that of a further shift of population from the country to the city. The reasoning is that the supply of agricultural things is overabundant. Producers of these things are overnumerous. Therefore, let their number be reduced. The trouble with this solution is that factory workers are also overnumerous. All breadwinners are overnumerous in America for the past few years. We, therefore, seem driven back to Dean Swift's solution for the Irish problem, eating so many babies every year.

The givers of the on-to-the-city advice never seem to stop to consider whether many people might not be happier on the land than in the city, assuming, of course, they could, as people have always been able to do until quite recently, sustain themselves on the land. After all, may not the land just be a place where a large part of the human race has to live and try to like it? Is the land to be thought of as a factory from which to extract money crops, or, as Mr. Hoover would say of agriculture, "an industry"? It is evident that there are too many growers of money crops, but does this fact prove that there are too many people on the land?

The advisers of a further shift of population from the country to the cities should give more thought to the present incapacity of industry to take care of its chronically unemployed. Perhaps they feel that, when times are good, the unemployed will be fewer, and that, when times are bad, they will get on somehow.

Fewer people are, however, now leaving the farms and the farm population of the United States increased in 1930 for the first time in ten years: 1,543,000 left the farms; 1,392,000 returned to the farms, and the normal increase by an excess of births over deaths was 359,000. The total farm population, therefore, grew 208,000 in 1930, to 27,430,000 on January 1,

1931. It has, of course, declined during the past twenty years and especially during the last ten years, being 32,076,000 in 1910 and 31,000,000 in 1920.[2]

The question of the desirability of a further shift in population from the country to the cities raises issues of a moral and philosophical nature, the exploration of which cannot be undertaken in this book. It is appropriate, however, to make the point that, as a matter of common sense, it is an easier problem in social engineering to enable people to support themselves on the farm than to assure for them in industry a livelihood under present conditions of world trade. The land has supported people since the dawn of the race. No one can say where or how the industries of the United States, England and Germany are all going to find markets.

If capitalists were as intelligent in their support of capitalism as they have been greedy in the pursuit of profits, they would make the farmer the subject of their special solicitude. In no other field of human activity is the percentage of capitalists so high as in farming and in no field are they worse treated. Of 9,801,000 private enterprises in the United States in 1928, 6,124,000 were farms, according to Dr. Wilford I. King's study of the national income. In agriculture 39 per cent are laborers, 37 per cent are full owners and 23 per cent are tenant farmers having a proprietor's interest in a considerable amount of productive property. In manufacturing the wage earners constitute 84 per cent of the total number employed. Of the remaining 16 per cent, a majority are salaried employees. The farmers purchase a tenth of our manufactures, pay 2½ billion dollars in wages and one-fifth of all taxes, though they receive but 9.3 per cent of the national income. The capital they have invested in agriculture is greater than that invested in manufactures, mining and railways. This investment represents one-fifth of the total wealth of the country.

The farmer, as a person, is not only the mainstay of capitalism but probably its last bulwark. So far as the fate of capitalism is concerned, the agricultural problem has to do

[2] *Crops and Markets*, March, 1931, page 94.

with this individual as a human being and not with agricultural production. In a moment of crisis for capitalists, a farm population composed of tenants and day laborers and an urban population made up of corporation employees would be a poor support for the institution of property.

CHAPTER XIV

HELPING THE FARMER OUT OF DEBT

GRANTING that the need of the farmer is greater bargaining power and that he can obtain this only by curtailing production, what ought government now to do for the farmer? The answer may be expressed in two brief groups of terms around which two series of ideas will at once crystallize: First, complete the deflation of agriculture, which is to say, reduce debt charges in measure as the farm income has been reduced by falling prices. Second, promote the settlement and development of the land along purely humane and non-commercial lines.

Mr. Hoover was prompt to take steps in June, 1931, towards reducing the debts owed by our foreign debtors. The German reparations burden was about 400 million dollars a year, resting on sixty-odd million German taxpayers. The American farm debt burden is about 700 million a year resting on some 27 million farm inhabitants, or on three or four millions of actual debtors. So far, Mr. Hoover has shown no interest in relieving the farmer's debt burden. Charity of this sort should begin at home.

The need of American agriculture, as of Germany and of the world at large, is to have an end with the agonies of slow and deadly deflation caused by the payment of large debts incurred in moments of war hysteria and high prices. Business cannot possibly revive as long as prices continue to fall or, even, as long as it must remain absolutely certain that prices cannot rise. The Germans cannot pay because of the impossibility of transferring the payments, even were they disposed to make the necessary sacrifices in their standard of living to effect such payment, and they doubtless have no such willingness. The farmers, on the other hand, are paying their debts by living on $425 per annum per farm family in 1930 and by

receiving a minus return on their capital investment. The worst of debts is that they have to be paid.

Contrary to the new economics, debtors can pay debts only by reduced consumption. The depression settled on the world when compounding interest overtook new lendings. Falling prices are the consequence of increasing production and decreasing consumption to pay debts. The report of the MacMillan Committee to the British Parliament (June, 1931) comes near to the heart of this problem when it says:

"A study of history would, we believe, confirm the opinion that it is in the changes in the level of prices and in the constant alterations in the position of debtors and creditors that the main secret of the social trouble is to be found."

This book says the same thing, though more forcefully and in greater detail. The only salvation of the American farmer is to get him out of debt and to keep him out of debt. The objections of those who dislike the shifting of debt burdens by state action may be met with the simple reply that the debtors, who are a majority everywhere,[1] do not like the shifting of debt burdens by the action of falling prices; neither do business men whose prosperity depends on the trade of the debtors rather than on the size of the income of the creditors. It is to the great credit of the members of the MacMillan Committee that they had the humanity to say in respect to a reduction of wages and an adjustment of debt burdens: "Our conclusion is, therefore, that if a substantial change should become necessary, it must be a general change and apply so far as possible to every class of income." And, further, "We see no solution of the grave problem of social justice presented by any proposal to reduce salaries and wages whilst leaving untouched money incomes which are protected by contract."

Impossible debts will be canceled. The only question is, How? This book prefers honest confiscation by tax levies to dishonest confiscation by inflationary measures. If a sweeping

[1] If the amount one pays to owners of capital, directly or indirectly, for the use of their capital exceeds the amount one receives from one's invested capital, one is a debt bearer, or really a debtor. The poor taxpayer is paying interest on the public debt. The poor bear most of the nation's debt.

legal revision of contractual debts has not been advocated, the only reason is that such a measure seemed at the time of writing avoidable if other, slightly less drastic, measures were taken. Tax levies are obviously the fairest means of effecting an even redistribution of the debt burden. Inflation is necessarily the least fair and usually most unfortunate way of redistributing the debt burden. But nothing can be as bad as allowing debtors to carry the debt load until they break down, and with them the entire economic structure collapses, as is happening in England.

There is no mystery about debts, except in so far as politicians and bankers create a mystery by inflationary schemes. Debts have either to be paid or canceled without payment. If they are canceled without payment, the creditor pays. The only important questions about debts are, Who pays? and How? Economic solutions which do not state clearly the answers they propose for these two questions are essentially dishonest. Some one always pays. An honest solution states clearly who, it is intended, shall pay.

If debts are so heavy that the debtors cannot pay, the only problem is how to redistribute the burden. The inflationary way has at last been adopted by England, and Mr. Hoover has started the United States in that direction with the launching of the National Credit Corporation to discount bank assets which are ineligible at the Reserve Banks, uncollectible, and unsalable. A similar scheme for creating inflation on the basis of mortgage and land credit is now being concocted. All such schemes are inflation of a type which will lead to an abandonment of the gold standard in the United States if carried far enough, and once they are started they cannot be controlled. Among other defects, these schemes do not give the debtor classes any relief until there is a collapse or suspension of the gold standard, because these schemes involve no reduction in interest payments. Furthermore, such schemes do not stimulate increased production because the purchasing power created does not exceed the interest payments to be met. Any scheme to relieve the debtors must extinguish a part of their interest

burden; not keep alive a worthless credit while charging the old rate of interest.

This book proposes a solution for the agricultural credit problem along the following general lines: an extinction of farm loans bearing between 6 and 7 per cent by an issue of government bonds bearing 3 or 4 per cent.

There are roughly 9½ billion dollars of farm mortgages outstanding. The average interest rate is about 6½ per cent. Let it be assumed that the government effected the conversion of 5 billion dollars of these mortgages into government bonds and remitted entirely the interest to the farm debtors. The cost in interest to the taxpayers would be 150 to 200 million dollars a year, accordingly as the rate on the government bonds were 3 or 4 per cent. The agricultural classes would be relieved of interest payments of 325 million a year. The farmers receiving this relief would pay off the principal over a period of, say, forty years. In measure as repayments of the principal of the mortgages were received by the government, they would be used to amortize the government bonds. A more rapid amortization of the government bonds could be made out of revenues. The interest burden on the taxpayers would decline progressively with the amortizations.

Farm mortgages would be bought only where the debtor farmer requested remission of interest and accepted the conditions imposed by the government. The government's plan would call for more detailed and technical formulation than it seems appropriate to essay here. The plan would exact the fulfillment of a supervised program of production and land development according to some scheme appropriate to the particular case. The objective sought would be better farmers and not money making.

In addition to the remission of interest on farm mortgages, the government should assist the development of better farmers by financing agricultural rehabilitation during a period of transition from money crop production to diversified crop production. No interest would be charged on these advances.

Subsequent profiteering by assisted farmers would prove

practically impossible. Before a farmer could profiteer, he would have to find funds with which to repay all remitted interest compounded to date, plus the outstanding principal. No farmer is likely to have a chance to profiteer in any near future, barring the event of war, and, in that event, government regulation of prices should make farm profiteering more difficult than it was during the last war. After a few years of interest remission, it would be nearly impossible for an assisted farmer to borrow enough on his prospects to pay himself out of his obligation, with compound interest, to the government.

Agricultural property having a nominal value of twice the amount of the acquired mortgages, or, say, worth an assessed value of 10 billion dollars, about one-fourth of the total agricultural property in the country would thus come under government control. This control would, as a practical matter, be largely one of restraint rather than direction. It might work out that the government would allow the assisted farmers to produce and do about as they pleased, except to borrow more money on the security of their land.

About all that is needed to keep agriculture on an even keel, once it is out of debt, is to prevent farmers from acting like good business men when there happens to occur a temporary rise in prices.

The beneficial results of certain important changes which the proposal would effect should be carefully weighed on their merits. The first change would be incidental to the mere process of substitution in the nation's investment portfolio of 5 billion dollars of 6½ per cent farm mortgages for the same amount of 3 or 4 per cent government bonds. The second change would be in the incidence of the nation's interest burden, by reason of removing 325 million dollars of interest charges from the farmers, perhaps not more than 2 million debtors, and laying 150 or 200 million dollars more on the shoulders of 120 million taxpayers. The third change would be the effect on trade of the transfer of income.

The first change would be incidental to the refunding of 6½ per cent mortgages into 3 or 4 per cent government bonds

The buyers of the government bonds would, in largest part, be financial institutions like banks whose credit potentialities are at present inactive for want of eligible borrowers and safe interest bearing bonds of adequate price stability. The money they would divert to the purchase of the government bonds would not constitute any curtailment of credit for commercial uses. On the other hand, the owners of the farm mortgages are, in large part, individuals who, if paid off, would at once seek other investments or uses for their money which would be more speculative than those eligible for financial institutions. Of course, many holders of farm mortgages are life insurance companies. Many of them would probably reinvest the money received from the payment of the mortgages in the new government bonds. Without producing any quantitative inflation of long-term credit instruments, primarily, the operation might give rise to some secondary expansion of credit which, in the present situation, could hardly be harmful. There would be no mobilization of worthless assets. If the government bought some worthless assets, they would be paid for promptly out of taxation. The debtors would not be paying interest charges on worthless assets. There is no lie involved in the operation. It is not a productive investment by government in farm mortgages. It is an honest, straightforward government subsidy to economically submerged agricultural debtors. A subsidy out of taxation is not inflation.

It should be clearly understood that the recommendation involves no spending by the government of borrowed money. The operation would be one of converting 6½ per cent farm debt into 3 or 4 per cent government debt, to the advantage of the debtor farmer and at the expense of the national taxpayer.

This brings us to the second change involved in the proposal; namely, a shift in the incidence of the nation's interest burden, in so far as 5 billion dollars in farm mortgages or 325 million dollars annually in interest payments are concerned. The income of all interest receivers, or lenders, would be reduced from 325 million dollars to 150 or 200 million. The income of the debtors, or interest payers, would be increased

by a net 325 million. The income of taxpayers would be reduced by 150 or 200 million. In other words, under the proposal, the income of the farmers would be increased by exactly the amount the income of taxpayers and interest payers would be reduced. There would, therefore, be absolutely no difference in the monetary amount of the national income: 325 million more for the farmers, 150 million less for taxpayers and 175 million less for lenders.

What would the farmers do with the 325 million dollars more in income? This brings us to the third change, namely, the effects on trade. The farmers would obviously spend these 325 million dollars of remitted interest on better living. It would tend to raise the average income of the 6 millions of farm families from the $425 of 1930.

Are we not better off as a nation to end the extreme privation represented by these interest payments and thus to create a domestic market for American goods than to send the goods abroad for foreign consumption in return for foreign paper? Under this proposal the taxpayer and money lender surrender 325 million dollars to the farmer, but America will be the richer for additional production called forth and effectively marketed in this country. Under the foreign loan method, no one appears to pay at present, since it is not admitted that the buyer of the foreign bond pays, but the country is the poorer for the goods exchanged for foreign I.O.U.'s.

Moreover, selling American products for foreign paper is pure inflation, while enabling farmers to spend 325 million dollars more by reducing the interest income of money lenders, say, 175 million and the income of taxpayers 150 million is not inflation. It is exchanging American manufactures for farm products, instead of exchanging interest receipts for farm products.

Critics may object that the interest which would be remitted to the debtors and spent by them under this proposal is now being received and spent by the lenders; hence, the proposal would not increase the amount of consumption or production. The objection is met in a later chapter entitled "Are Foreign

Loans Necessary for Prosperity?" Briefly stated, the refutation is that the money income of money lenders during a period of depression is not fully and promptly spent or reinvested. It is hoarded, and wisely so, for the simple reason that almost any investment made in 1930 was worth less in 1931 and there is a good prospect that 1932 prices will be still lower. What is needed to stimulate more investment and check hoarding is more consumption. More consumption can be financed only by taking more money from taxpayers and money lenders and giving it to the debtors to spend. Because this is done during a war, we have war prosperity. The proposal under discussion accomplishes on a small scale the same result without a war.

The proposal is a subsidy, exactly as the tariff, but insignificant in comparison therewith. It is a subsidy to consumption of more manufactured goods and to the production of fewer agricultural goods. This book, in a later chapter, will defend the tariff. It is, therefore, consistent in supporting a modest subsidy to agriculture. The noteworthy quality of this subsidy to agriculture and the features which distinguishes it from most farm panaceas is that the proposal is not a subsidy to encourage agricultural production. To those who object to government subsidies, it need only be said that we live in a society of subsidies. One has a right to criticize the object of any particular subsidy of which he disapproves; no one who uses the mails or uses the innumerable facilities of our civilization has the right to criticize the principle of a subsidy. To those who balk at the size of the amounts discussed, the reply can be similarly brief: remedies must be adequate to needs. Sending a boy to do a man's job is never good business.

To those who do not like taxation in principle, it should be said that they have the choice of (1) inevitable defaults now in course everywhere, (2) dishonest inflation and subsequent legal devaluation with the accompaniments to be noted wherever these expedients have been used, or (3) honest taxation. The capitalist has his wealth confiscated by taxation, to be sure. But he has it no less confiscated by defaults on bonds and mortgages—the present process. That inflation and sub-

sequent legal devaluation is confiscatory of property in bonds, mortgages and fixed money obligations is self-evident. Taxation would get the agony over quickly and give immediate stimulus to production and accumulation of fresh capital. Fighting for worthless values is poor capitalism.

Impossible debt burdens simply are not borne by debtors. Redistribution of the burden always occurs. Taxation is a rational, honest and advantageous way of effecting it. But it requires social intelligence and moral courage to apply. Consequently, statesmen turn to the printing press and credit corporations to sustain the credit values of impaired or worthless assets. To sum up the larger moral issue involved in this chapter: The state ought to develop in agriculture an asylum of common sensed living as a place of refuge from the insanities of our overcrowded industries. Agriculture can be made to absorb large numbers of unemployed who are content to live on the soil.

CHAPTER XV

CHEAP GOODS OR SECURITY?

ALTHOUGH only about 10 per cent of our annual production of movable goods in recent years has been exported, foreign trade may be studied as the key to our entire economic development since 1914. Even in agriculture we have seen the profound influences of the war, and it has been evident that those influences operated mainly through the mechanisms of foreign commerce. An excellent method of approach to the subject of foreign trade would seem to be a discussion of two important bodies of foreign trade doctrine, called free trade and protection. These doctrines should make the subject fairly real to the average citizen who has voted on and followed campaign arguments.

The case for free trade may be epitomized in the one word, cheapness; while the only universally valid argument for protection may be summarized in the term, security. For a brief presentation of the free trade case, no better quotation can be made than from Professor Jacob Viner, writing in the London *Nation and Athenaeum* of February 7, 1930, against the adoption of protection by Great Britain. Dr. Viner wrote: "There are only two sound economic arguments for free trade, one positive and the other negative. The positive argument is that the fact of trade establishes an overwhelming presumption that the commodities obtained from abroad in exchange for exports are so obtained at lower economic cost than that which the domestic production of their equivalent would entail. If this were not the case, they would not be imported, even under free trade. . . . The negative argument rests on the weakness of the objections which the protectionists have been able to accumulate against the simple positive argument for free trade.

It is for this reason that the free trade argument consists, in bulk, mainly of refutation of the objections to it."

Security is the only watertight protectionist argument. If protectionists confined themselves to its logical development, they would put up a better case in debate with academic economists and, at the same time, lose a great many votes at the polls. Hence the protectionists lose in debates with the professors and always win in the political forum. Just what this proves, it is hardly necessary to discuss. It is perhaps apposite to remark that the fact that protectionism has gone on from triumph to triumph while the professors have constantly proved to themselves its absurdity suggests strongly that the professors may not be discussing the entire question in terms of reality. Inasmuch as this book is not trying to sell high tariff (the recent sale to England and Denmark about completes the list of high tariff countries), an attempt is made to meet the academic free traders on their own ground.

There is an excellent vote getting argument for protection, namely, the full dinner pail. In countries like the United States, Canada and Australia or any underpopulated country richly endowed with raw materials, this argument had considerable merit. As the United States is unquestionably richer in natural resources than most densely populated countries, except China, it follows that, under any economic system, a higher standard of living is physically attainable here than in countries like Germany and Japan. The free traders are, therefore, quite correct in replying to the protectionists that our higher standard of living is due to our superior natural advantages rather than to our tariff. They are not correct, however, in implying that, under any free trade or lower tariff régime, the balance of power between capital and labor would not be changed to the disadvantage of labor and to the detriment of that large group of business men whose prosperity depends directly on the volume of purchasing power commanded by labor. The labor phase of protectionism will be discussed more particularly in the next chapter.

Security has been the long run, little understood and seldom

clarified reason why we went protectionist during the Civil War period, Russia in 1877, Germany in 1879, France in 1881 and why practically the entire world, except England and Denmark, were high tariff at the beginning of 1931. By the end of 1931, England and Denmark had joined the ranks of the protectionist countries.

The emphasis given to security as an argument for protection is peculiarly relevant to the underlying welfare theme of this book. Welfare is not, as free traders have always seemed to suppose, entirely a matter of cheap and abundant goods. No matter how cheap goods are, the unemployed can always be without money to buy them. Security, in the sense used in this chapter, is a relative degree of immunity from the reactions of international disturbances as they are reflected in domestic prices, production, employment and the distribution of the national income.

For greater economic self-sufficiency, one unquestionable element of national and personal security, tariffs have proved a useful instrumentality. Tariffs have not afforded absolute or perfect security any more than any degree of wealth has ever yielded complete happiness, but tariffs have contributed towards greater security. They have neither the virtues nor the vices commonly attributed to them.

Nothing has confused the free trade-tariff question so much as the unwarranted claims made for both systems by their respective supporters and the false charges leveled at both systems by their respective critics. Either system affects profoundly in different ways the quality of a nation's output, the integration of its economic structure and the degree of its security from economic changes. Neither system can be said to have any noticeable effect on the total quantity of production over the long run. Certainly neither system can be fairly called a sure way of helping or destroying trade. Proof of this statement is best obtained by a glance at the facts of recent economic history and at the present plight of either free trade England or high tariff America or Germany.

Free trade and protection are influential in any number of

ways, but these systems are not significant in the long run stimulation or depression of trade. The total volume of business may never be said to depend over a long period on tariff policies. A sudden tariff change might have an important effect on total production for a short time, but adjustments and compensations would quickly follow. Production and trade factors behave differently under the two systems, but the total quantities do not appear to be greatly affected by these two policies. This conclusion was embodied in the conclusions reached by the Australian Tariff Commission of 1929, composed of the ablest economists in Australia. The following extract is quoted:

"From these various and contrary influences we conclude that the policy of protection has not had any very great net effects on the prosperity of the country as a whole. It has not brought the benefits expected nor has it been disastrous."

It should be added that the Australian tariff is 25 per cent higher than the American tariff.

It was absurd of the American academic free traders to teach their classes that England owed her prosperity for generations to free trade, roughly, from the Repeal of the Corn Laws in 1846 (the act that sealed the doom of the British people in the 1930's) and that the United States flourished in spite of protection. It is no less absurd to say in 1931 that world free trade would relieve the depression, the integration of industry and other important factors being what they are. A big war would end the depression for tariff and free trade countries exactly alike.

Another popular misrepresentation has been the argument that free traders are the opponents of economic discrimination and injustice. This fallacy is most easily refuted by the statement that English free trade manufacturers developed their industrial supremacy with the aid of discriminatory policies of government, and that, as these advantages were withdrawn, British free trade industries went into decline. Colonial enterprises, constant wars and military expeditions, foreign conquests, and national defense were the subjects of huge expendi-

tures for the peculiar benefit of British manufacturers. As Kipling wrote, "If blood be the price of sovereignty, Lord God, we have paid in full."

Having thus, at the outset, attempted to bring into sharp focus the contrasting arguments of cheap goods and security as the essentials of the tariff-free trade controversy, let us next point out the weakness of the cheap goods argument. The point of this refutation is that security and even distribution of income are more essential than cheap goods. It must be kept in mind that the problem is not one of a simple choice between cheap and dear goods or between abundance and scarcity of goods.

The classical free trade assumption is that without tariffs and political hindrances to the international exchange of goods and services, the people would benefit from an abundance of goods at minimum economic cost. Production would follow maximum relative advantage in producing. It is assumed that where goods are cheapest and most abundant, welfare must also, of necessity, be most abundant. These plausible assumptions disregard entirely certain realities of the working of the money and price system, especially in connection with the distribution of purchasing power.

In disregarding the consideration of security, to which brief attention has already been given, the free trade case assumes a static world in which nothing unpleasant—like wars and Wall Street follies—ever occurs. The free trade case also completely begs the questions of unemployment and distribution of the national income. The weakness of the assumption just mentioned is that we cannot create such a world by wishes nor yet by the adoption of free trade. As for begging the question of unemployment, it is not only illogical but it is inhuman.

The free trade case overlooks certain basic facts, such, for instance, as the following: The reason why most consumers do not spend more or live better is the lowness of wages quite as much as the dearness of goods. This idea could be phrased with greater neatness and technical accuracy, but it is desired

to emphasize the contrasted factors of dear goods and low wages.

To cheapen goods and lower wages concurrently helps no one. When cheaper goods result from free trade, or competition, lower wages are always an accompaniment. The significance of low wages as distinguished from high prices is a matter of distribution of the national income, not of numerical relations between quantities of money and goods. Prices are in themselves of no importance for society. It is their movements up or down which have significance.

Rising prices, ordinarily, mean expanding production and consumption, and falling prices the exact opposites. The depressive effects of falling commodity prices may for a time, as from 1920 to 1929 in the United States, be exceptionally offset by credit inflation of security and land values, but, such inflationary developments being necessarily of limited duration, it must always transpire that falling commodity prices eventually reduce production and consumption. (This process began in America in July, 1929.) The reason mainly is that business people do not like to lose money on falling prices, and investors have the same feeling about the matter. Welfare depends largely on the total volume of production and consumption. This volume does not depend on the level of prices but on their trend. While free trade, the world over, was lowering prices, it would be tending to reduce production and consumption. After world free trade had brought prices to a lower stable level, though the economic cost of goods might be less, there is no reason to suppose that the total volume of production and consumption would be greater than at present. The initiative for increased production would have to spring from rising prices again, and these, in turn, would only result from some non-commercial factor like war, new inventions, new tastes or new spiritual forces.

Free trade propaganda is an excellent device for obscuring the fact that 99 per cent of the people in the United States receive but 88 per cent of the total income. No free trader has yet undertaken to prove that, under free trade, the percentage

of the income received by the 99 per cent would be increased. Free traders merely try to prove that, under free trade, the total output would be greater. In a static world not dominated by the profit motive this assumption would seem plausible. In the actual world it is not well founded, because competition has its costs which must be paid out of the social dividend.

When the free trader talks cheap and efficient production he forgets, or merely disregards, the fact that, in measure as production may be cheapened and increased, the larger part of the gain may be taken by the 1 per cent of the people and invested by them in factories that stand idle, office buildings that remain vacant, or in country estates that delight the gaze of comparatively few people, or, worse still, in foreign bonds. Of course, it is believed in the United States that money is better so spent than on public works which, to quote Mr. Hoover, might not be "reproductive" and which would, "in consequence," be "sheer waste."

Speaking of increased cheapness and efficiency, it is difficult to see what satisfaction the 6 to 8 million unemployed in 1931 derived from the fact that goods were 50 per cent cheaper than in 1919 when there were less than a million unemployed. The fact that, in 1929, 8,743,000 workers in industry added to goods by manufacture a total value of 31,687 million dollars, whereas, in 1919, when prices were twice as high, 9,039,000 workers added only 24 billion dollars in value by manufacture can have afforded little nourishment to the millions of unemployed in 1929.

When the free trader talks cheap goods he fails to grasp the elementary fact that 99 per cent of the people are better off with 88 per cent of an output of 100 than they would be with 78 per cent of an output of 110; or, that they would be happier still with 99 per cent of an output of 90. What the thinking people among the 99 per cent are most concerned over is not how much is produced, but how much each one of them can be reasonably sure of obtaining by honest toil.

In a series of "Economic Notes on Some Arguments for Protection," Professor Lionel Robbins, an English free trade

professor, says:[1] "May I commence by enunciating a platitude? The main objective of economic policy is not to cure unemployment: it is to increase the social dividend." Of course, it is quite impossible to conciliate this orthodox free trade position with that taken by this book. The conflict is, obviously, not one of logic but of two emotional attitudes towards the realities of human suffering. The free trader demands maximum output of goods regardless of the number of the unemployed or the amount of human suffering incident to a maldistribution of income. A maximum social dividend, regardless of its distribution, means for him maximum welfare. The mentality of the free trader was formed amid the factories of mid-Victorian Lancashire, where emaciated women and stunted children worked twelve hours a day and where the unemployed were left to starve or emigrate. For the realist who is incapable of such emotional indifference to human suffering, it is impossible to beg the question of unemployment.

Professor Robbins continues: "If by curing unemployment that end [increasing the social dividend] is accomplished, well and good. If the cure involves measures inimical to the increase of the dividend, its desirability is more dubious. We know perfectly well that a general impoverishment would make us all work harder. It is yet to be shown that more work in this sense is in any way desirable." This book asks point-blank, "Why would not an impoverishment which gave all work and a more even distribution of income be better than greater wealth, in the midst of which a third of the population live on the verge of starvation and millions go without work?" It does not follow, however, that a more even distribution of income and work for all would, necessarily, reduce the national dividend. The argument of more goods regardless of the distribution, is not so much a plea for a larger dividend as it is a demand for the right of certain people to produce as much as they like of what they like. Free trade is a state of feeling about goods and profits and not about human welfare.

Also, free trade competition has its costs which free trad

[1] *Economica*, February, 1931.

advocates have always left out of their accounting. Sometimes these costs can be postponed, concealed or passed on to foreign consumers. In the long run, however, society pays for scrapped industries and idle workers. And in the long run the country that scraps most will pay dearest. It is a mad economy in which the function of industry is not primarily to furnish steady jobs rather than cheaper goods. Without jobs, people cannot buy goods. Cheap goods are a free trade delusion and the classical economist's blind spot.

An ideal tariff policy should be high enough to assure the satisfactory operation of the largest variety of industries the nation can comfortably afford. Tariffs practically never bar foreign products which cannot be manufactured at home. The American tariff, one of the highest, only taxes one-third of our imports, leaving the other two-thirds to enter duty free. Sugar pays a duty which at present prices amounts to over 200 per cent ad valorem. Rubber is duty free. Yet we are the largest per capita consumers of sugar and rubber. The sugar duty makes us pay millions a year in tribute to Senator Smoot's protégés, but what of it? We pay several billions a year in toll to people merely because somebody finds oil under their land or because they were lucky enough to buy land in certain places. Inequities are inherent in our economic system. The inequities of the tariff are compensated by the greater security it gives us and the superior bargaining power it gives to labor.

To assert that tariff has restricted our foreign trade is absurd. From 1900 to 1929 our population increased 62 per cent; our exports rose 276 per cent and our imports 418 per cent. Reducing values to 1913 levels, our imports have increased from 100 to 180 since 1914, while British imports have increased only from 100 to 114 and world imports from 100 to 122. Our imports were only 85 per cent of our exports in 1922. We boosted the tariff in September, 1922, and the next year our total imports were not only larger but increased to 95 per cent of our exports. Our tariff rates have never been so high as since 1922, yet there was never a period of seven consecutive years since 1895 in which our imports formed as large a percentage

of exports as in the years 1923-1929. Needless to state, the volume of our foreign trade during this period broke all past records for a similar period.

As for the much denounced tariff of 1930 which failed miserably to raise prices as the free traders prophesied or to stimulate trade as the protectionists promised, it was followed by a big decline in foreign trade. But imports were 85 per cent of exports for the first seven months of 1931 as compared with 83 per cent during the same period of 1930 before the passage of the Tariff Act. It is just as unreasonable to attribute the decline in foreign trade or in total production to the Tariff of 1930 as it is to give any credit to the Tariff of 1922 for the seven years of prosperity which followed it. The fact is that the tariff is not important in the ways its advocates claim and its critics charge.

We do not need foreign trade to furnish us with cheaper goods. We only need foreign trade to supply us with goods we cannot produce at a reasonable cost ourselves. The money or economic cost of goods is largely subjective. We do not, or should not, care how much we may have to pay of our labor and resources for what we want, certainly not just at present. We need more labor cost, not less. We want no flood of cheap foreign goods merely because they are cheap. To accept such goods for a time and thereby to throw out of joint our national economy is inevitably to expose ourselves to grave dangers and to disserve public welfare. In the end, the immediate economy will be dearly bought.

Welfare comes not so much from abundant goods as from plenty of healthy work for everybody, a reasonably even distribution of what is produced; and, most of all, security for business producers and for employees. A nation is far happier to have a little and to be sure of it, with everybody evenly served and without fear of tomorrow, than to possess a great abundance of goods, like England, with millions of unemployed, a submerged poor and the haunting fear of changes in world conditions which will inflict the disaster of business failure and unemployment on millions.

CHAPTER XVI

LABOR PAYS FOR FREE TRADE COMPETITIVE ECONOMIES

FREE trade arguments break down where labor, as in England, refuses to accept a lower real wage and intrenches itself behind the dole. Real wages in British industry rose 10 per cent between 1924 and the second quarter of 1930, due, largely, to the fall in commodity prices. Money wages declined but 1.7 per cent during this period. What England gained in cheap imports, she was losing in the costs of the dole, or the support of the unemployed. She was, thus, bearing the costs of protection without any of its benefits.

It has thus been proved that the economies of free trade have to be realized at the expense of labor, as the competitive system actually works. If labor is strong enough to defend a high standard of living for the employed, it renders free trade virtually inoperative. The free trade economies cannot then be realized—at the expense of labor.

In so far as cheaper production may be due to improved productive efficiency, it may be and, in the long run, always is achieved quite as well in high protection countries as in free trade countries. For instance, the output per head of British workers in industry increased 33 per cent from 1907 to 1929, or 10 per cent from 1924 to 1929.[1] According to the figures of Dr. E. Dana Durand, director of the United States federal census, output per worker in American manufacturing between 1910 and 1920 increased 20 per cent and between 1920 and 1925 a further 13 per cent. Protectionist America has for the past thirty years enjoyed a standard of living roughly as much higher than that of free trade England as the British standard of living has been above that of protectionist Germany. The comparison with Germany, however, cannot take into account

[1] MacMillan Report, pages 54, 309.

the many social advantages received by German labor as gifts of the state. These differences in the real wage of labor in the three countries mentioned must be explained mainly in terms of differences in natural resources, in the bargaining power of national industry in international trade, and in the income from foreign investments, shipping and banking. Tariff is not the explanation. American labor was not better off because of tariff and British labor better off because of free trade vis-à-vis German labor.

It will be useful here to run over a few simple facts about the rise of British wages. The real wages of British labor rose from 45 in 1830 to 100 in 1900. From about 1895 to 1913, British real wages remained fairly stationary around 100, though this was the period of greatest increase in production per capita. This was, obviously, a period of increasing competition which lowered the margin of profit for British industry. During the war British real wages rose to 115 and they were, at the beginning of 1931, still at about that level. During the war munitions were needed to kill Germans, so British labor enjoyed superior bargaining power. Since the war, a stronger political action by labor has maintained this higher real wage, largely through the instrumentality of the dole. A large amount of unemployment has been, naturally, the price of the maintenance of these higher post-war wages, since labor was not strong enough or competent to go all the way and enforce a nationalization of industry.

During all the years since 1846 there has been no significant change in British free trade policy. British labor in the early days shared some of the advantages of British profiteering on the British monopolies in manufacturing, shipping and banking. Had Britain had a tariff, labor would have enjoyed greater bargaining power and would, in consequence, have arrested the development of British industry and foreign investments at its expense. There would have been less industrial expansion, less foreign investment and a smaller accumulation of wealth. There would have been a more even distribution of wealth and a slower growth of population. Agriculture would have been

conserved in proper relation to the food requirements of the country. There would have been fewer wars. England would be littler; its people humbler and happier. They would not be faced with the grim realities of the present moment, and the grimmer terrors of tomorrow.

With regard to the United States, the analysis of tariff-labor history must be somewhat different, due to the fact that we were a frontier country inviting settlement by European immigrants. In our case it may be said that, barring unlikely political action by labor, free trade would, as the free traders claim, have increased for a time the total output. In its distribution, however, free trade would have tended to give investors a larger, and workers a smaller, share than these respective factors received under protection. American investors might have received most of this gain and exported a large part of it in foreign investments which would have retarded the opening up of the new continent and tended to depress the standard of living of labor. These aspects of foreign trade and investments will be discussed at some length in the concluding part of the book.

It should be remembered that capital has greater international mobility than labor. Labor, being less fluid, is more nearly bound to stay put and accept the wage offered. During the past century laborers did emigrate in large numbers to the frontier countries. In those days labor in the United States, Canada or Australia, with a steady inflow of immigrants from economically stagnant and overcrowded Europe, had no country to which to emigrate. Capital, given free trade, could, with wage reductions, have exacted a larger proportion of the national dividend in America and could have exported a share of capitalist profits to finance profitable exploitation of cheap-labor-foreign industries flooding our markets with their output. A migration of capital can be effected by a phone call to a broker. A migration of labor is a serious business. With worldwide free trade, capital could exert a much stronger pressure on labor. The American international electric trust, whose leaders are considered saints by the American liberals, could,

under free trade, lock out their American employees and supply the American market with products from their European plants. Having broken American labor, they could put the same screws on the workers in their European plants.

Protection, from 1870 to 1910, by favoring domestic producers in the United States, and by excluding more economically produced foreign goods, fostered, precisely as the free traders charge, the development of less efficient industries in this country. But this was why American capital was invested at home and why it was forced or induced to compete for the services of American labor.

American labor was not, therefore, unintelligent in its response to the full dinner pail argument. The academic free traders have been individuals living on a fixed salary or income for whom cheaper goods would have spelled better living. Those for whom cheaper goods spell lower wages see a different logic.

A commission of highly competent economists, designated by the Commonwealth Government of Australia in 1929 to make a study of, and a report on, the Australian tariff, presented as one of their major conclusions the finding that:

"The evidence available does not support the contention that Australia could have maintained its present population and a higher standard of living under free trade."

The members of the Commission found that protection had cost Australia $180,000,000 a year, which, to free traders, is something appalling. But the Commission also found that protection had given Australia a higher standard of living, which to some people who are not free traders is not appalling at all.

Professor Viner's free trade answer to this conclusion of the Commission is as follows: "It [Australia] could have done just as well if it had followed free trade and hired a number of persons, reaching with their dependents 250,000 by 1929, to dig holes in the ground and fill them up again, and could have done much better if it had put them to work at standard wages building additional roads or parks or trapping rabbits."

Professor Viner is right as far as he goes, but, like most good

free traders, he does not go far enough with his thinking. He fails to add that governments, influenced largely by rich taxpayers, even in Australia, do not vote public money to dig holes as a means of giving employment to out-of-work laborers or of keeping up high wages and keeping down large incomes, whereas such governments do take kindly to tariffs. As long as taxpayers, business men and governments are what they are, labor would be stupid, either in Australia or in the United States, to support free trade. Robinson Crusoe economics may be a suitable device for transmitting economic concepts to college freshmen, but they are inappropriate to the bread-and-butter problems of life in a world governed largely by greed and cunning.

The broad fact that free trade economies can be realized only at the expense of labor has already been stated. The case in point—England—has been cited. Let us give brief consideration to the theoretical explanation of this fact.

The fundamental proposition in theoretical explanation of the incidence of the burden of free trade economies on labor is that the days of monopoly in productive efficiency are definitely over. Czechoslovak shoe factories have identically the same machines and methods as those of Brockton, Massachusetts. Under modern Gilbreth and Taylor methods of factory administration, about all the majority of workers do in any efficient plant is to perform one or two extremely simple mechanical operations. A man who is adequately supplied with the bare necessities of life, costing $1 a day, will perform these simple operations quite as well as an operative receiving $5 or $7 a day. The upshot of it all is that, under world free trade, the only real field of competition would be the standard of living of workers. Our international bankers are great believers in a régime of international equality for labor.

Needless to say, reducing costs by lowering real wages invariably starts a movement in a vicious circle which brings the producer back to the dilemma from which he fled, labor having had its standard of living lowered in the silly process. Free trade merely serves to accelerate the velocity of the movement

in this vicious circle in which capitalistic industry is today madly turning. Protection artificially retards this type of competition. Protection does not eliminate such competition; hence, there is no point to criticizing protection on the ground that it has not avoided many of the evils of competition. Protection is merely a brake on competition.

Cheapening production costs by lowering wages is often futile for the simple reason that the goods cannot be sold in appreciably larger quantities, whatever the reduction in production costs and selling prices. The reasons may be the inelasticity of demand, especially where food and raw materials are involved, or an absolute decline in demand due to important economic changes, such as the length of women's skirts, the fad of thinness or something else.

For example, to get away from our wheat and cotton surpluses, the British coal producers, thanks to a raise in the work day from 7 to 8 hours, following the unsuccessful coal strike of 1926, lowered costs and prices by $1 a ton. Three years later, sales had dropped 139,000 tons a month, for reasons unconnected with tariffs or trade hindrances. Increasing use and overproduction of crude oil were among the reasons. The problem of the British coal industry might have been solved by the creation of new uses for electric power to be supplied by power plants built near the mine heads.

If there is something wrong with an industry, lowering wages and production costs will rarely right it. If the industry is a large one, lowering wages will never solve any problem. The American farmer, as has already been shown, is a striking victim of a failure to comprehend the point of Adam Smith's remark a hundred fifty years ago about the inelasticity of the human stomach.

The effect of world free trade would be greatly to augment the present-day army of the technologically unemployed with those thrown out of work as a result of constant eliminations of industrial losers to more efficient foreign producers. Foreign competitors would be doing exactly what new machines have been doing for the past two decades with increasing deadliness.

The slightest change in world economic conditions, which no one could foretell, in most cases, would suffice to put hundreds of American producers out of business or on reduced output. There might be just as many foreign as American losers in such competition. The competitive honors might be even. The competition might, at first, give cheaper goods. For labor, however, the important fact would be the increase in business casualties due to the change from a régime of tariff-sheltered industries to freer competition. For every casualty there would be an immediate increase in the number of the unemployed casuals.

It is a false argument, the fallacy of which will be explained, to say that men thrown out of work eventually find other jobs. Sometimes they do; often they do not. Be that as it may, the fact remains that there is a permanent army of casually unemployed. Technological changes are at present keeping this army about as steady in size as the conscript system keeps the standing army of France or of Russia. It is as idiotic to say that technological unemployment is not a menace because the technologically unemployed are eventually reabsorbed into industry, as it would be to say that a conscript army has no importance because the conscripts do not remain long in military service. Importance attaches to the size of the army of the unemployed, not to their term of idleness. About the only thing American engineers and business men were able to stabilize from the war to 1929 was technological unemployment.

This book draws a close parallel between the economies of free trade and of the displacement of labor by machinery. Both types of economies give cheaper goods and beg the question of what happens to the unemployed. As long as the British unemployed could be left to starve or emigrate, free trade was a huge success. It was possible to maintain high and profitable exports by means of loans taken out of a surplus sweated from British labor. As long as additional quantities of goods could be sold internally on a 72-billion-dollar expansion of interest bearing debt (1920-1929), our business men and academic

economists could boast of the beauties of technological efficiency.

It seems appropriate at this point to refute the reabsorption of labor fallacy, which is a part of the free trader's defense of competition and the business apologist's defense of technological unemployment. The best proofs of the fallacy are walking the street by the millions hungry and jobless, in England and America, and have been for nearly a century. But such proofs have little meaning to classical economists.

Professor Douglas, a highly competent academic authority on labor questions, writing on *The Problem of Unemployment* (page 31), argues that technological unemployment takes care of itself. He reasons that the money saved on production must find its way back into trade and investment, a process which, in turn, reabsorbs the workers displaced by new machinery. The same argument, of course, applies equally to workers who would be displaced by successful foreign competitors under free trade. Professor Douglas at the close of his argument makes the following reservation to save himself from one line of attack: "If a lag develops in this process of reinvestment, then there will be, to that extent, a decline in monetary purchasing power and probably an increase in unemployment." The fact, of course, is that whenever prices are falling there is certain to be just that lag. This important fact, which receives but scant mention in a closing sentence, might well have been the subject of the entire chapter instead of a great deal of fallacious monetary and investment theory.

Professor Douglas' fallacious labor reabsorption argument at once elicited a chorus of smug editorials commenting with evident satisfaction on the gratifying academic proof just furnished that there was no reason for anyone to get excited about technological unemployment which automatically solved itself, given a little time and patience. And American business men and professors have shown extraordinary patience with the unemployment of 6,000,000 men.

The fallacy of Professor Douglas' argument was competently exposed in a technical paper by Professor Alvin H. Hansen,

entitled "Institutional Frictions and Technological Unemployment" appearing in the *Quarterly Journal of Economics* of August, 1931, to which acknowledgment is made for the formulations of the next paragraph.

The fallacy here is that it identifies demand for labor with demand for goods. Economies in production give consumers more purchasing power but this gain is offset by the loss in the purchasing power of the discharged workers. Consumers are able to buy the same quantity of goods for less money, but the workers thrown out of work cannot continue their former purchases. When improved processes yield more goods for less cost, the purchasing power set free by the reduction in price is sufficient to maintain the former demand for goods, despite the reduced purchasing power of the displaced workers. But this released purchasing power is not sufficient to maintain the former demand for labor. The proof obviously is that the former number of workers are not kept employed.

As Professor Hansen points out, "If we could assume that the displaced workers had somehow found new employment and were again earning wages, then indeed there would be a net gain in total real purchasing power arising out of the additional goods which they produced. But this is to assume a problem solved without explaining how it happened."

It is a characteristic peculiar to that school of economists classified by Professor Charles Gide as the optimists that they assume the existence of a good fairy who watches over business and sees to it that in the end everything works out for the best. There is no doubt that everything does work itself out in this world, as the human race continues to survive wars, pestilences, famines and business ways. To find this economic philosophy satisfying, of course, requires an emotional attitude which many people lack, not being optimists.

The defect of free trade is that it assumes the existence of a good fairy to look out for the unemployed. The British, for a long time, had a world situation which they were able to exploit successfully with the free trade system. Free trade economists have considered a situation a system. There are still people,

mostly in America, who imagine that free trade can be made to work by forcing labor to accept a lower standard of living, in the good old-fashioned way. British men of property, however, are much too near Russia to consider seriously any such attempts. They prefer a few more years of capitalistic life with the dole and a tariff. Most of them, of course, realize that the days of capitalism in England are numbered.

A not unintelligent official of the United States Chamber of Commerce is reported to have said, venting his feeling about the dole, that if this country ever came to adopt it, we might as well consider ourselves on the toboggan. His apprehensions are not without foundation. Once labor obtains state insurance against starvation, capitalists have started on the journey that Louis XVI began the day he was escorted by the populace from Versailles to Paris. Human nature never weakens or grows meek on power. The dole ended free trade. And a tariff war will probably end British capitalism. Britain's doom was sealed the day the Corn Laws were repealed and the British manufacturing classes came into full power to make of England an economic unit which cannot subsist in the world of today.

Most of what has been said in the present chapter is expressed, somewhat more guardedly, in the following words of the MacMillan Report: "The fundamental argument for unrestricted free trade does not apply without qualification to an economic system which is neither in equilibrium nor in sight of equilibrium."

If the members of the MacMillan Committee were forced to define clearly what they meant by "equilibrium," they would, most likely, describe the nineteenth-century situation of world trade in which British manufacturers had a monopoly in foreign markets and the whip hand over British labor. That peculiar situation has departed forever. The case for free trade has departed with it.

CHAPTER XVII

INTERNATIONAL COOPERATION—A MISCHIEVOUS FALLACY

INTERNATIONAL cooperation is a misleading idea. We live under a system of capitalism and nationalism. Both principles are essentially individualistic, competitive and non-cooperative. The only alternatives to this system, which have been put into practice in modern history, have been personal despotisms and communism. The question is whether the United States is going forward to Marx and Lenin or back to Washington and Jefferson. The international bankers and American liberals of internationalist leanings have been leading this country straight towards communism, though few of them have been sufficiently philosophical to realize it. The point is that, to cooperate, one must have something to cooperate about. The nations of the world have as yet no common basis of cooperation; the people of the United States want none; and, if they did, they could not find it in competitive trade relations. You cannot cooperate about competition.

A veritable army of kind souls, some of whom will probably not be any too kind about it, will at once exclaim, "But, the nations can cooperate towards maintaining peace." In reply, it is denied that the nations can cooperate in the maintenance of peace except on the basis of a common faith, like Christianity (of a sort yet to be generally practiced), communism (now being practiced), Moslemism, Buddhism or some other great religion. Cooperation to keep the peace is impossible because there are as many varieties of peace as there are opinions and wishes on the subject. Nations can cooperate in fighting for peace but not in keeping it.

War, with its immediate objective of killing people, has always had the final objective of peace. Nations at war are

always fighting for a just peace, and these are the only periods during which nations are effectively cooperative. The reason wars occur is that A does not like B's brand of peace. The use of war as a means of changing or upholding the peace is nearly as common to most vertebrates as the functions of reproduction.

The fact is that nations with conflicting ideals can cooperate over the pursuit of peace through killing people, but not otherwise. They can agree about the peace, until they get it, and they develop a most remarkable unity of feeling about killing people to obtain this peace. This is why most pacifists, except those of the genuine, non-fighting kind, like Mahatma Gandhi and Doctor Einstein, are the world's greatest menaces to peace. Nothing can start a war so surely as plenty of international cooperation. Then the events of war cement the bonds of fellowship and promote cooperation until the killing is over.

A state of world peace is by no means inconceivable, but it is inconceivable in a world of capitalism and nationalisms. A real state of world peace would require, as a condition precedent, the conversion of all mankind to some one great unifying spiritual idea, be it the ethic of Jesus, the revelation to Mohammed or the materialist concept of Karl Marx. World peace on any other basis is but an armed truce during which the situations created by past wars and, particularly, by the last one, are conserved to the satisfaction of the winners and to the dissatisfaction of the losers. True peace can only be a state of feeling in the hearts of all men, not acquiescence in given situations until the moment seems opportune to challenge them.

It is important to understand that attempts to bring the world under the sway of some one great spiritual idea would not emphasize the element of cooperation. The cooperationists would do well to give some thought to this consideration. The big fact about ants, perhaps, is that they are cooperative. The important fact about men is that they are not. Should all mankind ever form a truly cooperative fellowship, like a beehive, such as the communists, American big business men and certain of their intellectual acolytes seem to envision, the important fact would not be cooperation but the objectives in

the pursuit of which universal cooperation would be practiced. Undue emphasis in America on the idea of cooperation is proof of the extreme spiritual poverty of the people. The highest spiritual values of man must always rise a little above the summit of an ant hill, or the ideal of cooperation.

The League of Nations, no more than the Roman Empire or the Holy Alliance, offers a semblance of a world peace plan. The League and its supporters merely ask that the nations keep the peace of the victors. And Japan, one of the victors, has already violated the peace in complete contempt of the League quite as flagrantly as Germany violated the neutrality of Belgium. Now it follows that the more cooperation there is in upholding the present peace of the victors, or a presumed majority, the more cooperation there will be in the next war to break it. The more effective the League of Nations and the international bankers are in involving all the nations in the maintenance of the existing peace, the more reasons there will be why a large number of nations will be drawn into the next war.

It will be said, of course, that the League and the World Court provide peace machinery for settling differences and even of changing unsatisfactory phases of a peace status. And above all, we are told, machinery exists for dispensing international justice. Nothing could be more naïve than the thought that justice is something absolute which can be produced by pulling a lever if one only has the right machine. It is, of course, a thought nurtured by that most unscientific of all professions, the law. Justice is only the opinion of the majority. Majority rule among individuals yields relative peace, extremely relative in many American cities—thanks to plenty of policemen, machine guns and jails. Majority rule among nations also yields relative peace, thanks to plenty of wars.

Justice is merely a state of feeling in the hearts of men, a thing of the emotions, not a machine-made article. When an international tribunal or municipal court grinds out a product called justice, the machine has only made explicit a state of feeling of a majority about some given question in dispute, be

it the right of Germany and Austria to form a customs union, the number of votes cast for Hayes and Tilden, or the guilt of Captain Dreyfus.

If all men felt the same about each other and the larger problems of human destiny, that feeling would constitute international justice. The result would be international peace. As a part of this order of things we might have the slaughter of every first-born male, four wives for every prosperous citizen, the deification of Mr. Hoover as the supreme ruler of mankind at Kalamazoo or Bagdad, the immolation of all widows on the funeral pyres of their deceased husbands or the organization by Mr. Owen D. Young of all mankind into efficient industrial units. But it is certain that, as a part of such world peace and international justice, we should not have American discrimination against the yellow races; nor should we have the values of German and Gallic cultures. There would be one civilization, one faith, and one common destiny for the common brotherhood of man.

Those who are fascinated by the idea of international co-operation should consider carefully its technical as well as its ideological requirements. A world consisting of one superstate would have to be ruled by an economic dictatorship which would order the following acts: (1) all investments of capital in all economic enterprises as to amount, distribution and management; (2) the output of every enterprise, including farms, as to both quantities and articles; (3) the prices or ratios of exchange between all goods and services produced. Such a dictatorship could, of course, be conducted according to the ideas of Jean Calvin, Karl Marx, Brigham Young or Signor Mussolini. (Possibly even of Mr. H. G. Wells.)

But, if one has not for the governance of men in their national and international relations an intelligible ideal like the golden rule or communism or the cæsarism of one man, the alternative policy—that upheld by this book—must be a policy like that of Washington or Jefferson. We must accept the inevitability of European and Asiatic wars; live and let live; and, above all, mind our own business. For the United

States to depart from these pragmatic norms, as we have been doing since 1916, and to go chasing justice, which is to say, taking somebody's side in every international brawl, is not to avert the next war. It is merely to make sure that we are in it. It is international cooperation, right enough. But that is just what is wrong with it.

The more we allow our foreign investments to grow, and the more our statesmen and bankers involve us as a nation in international situations to protect these interests, the more certain becomes our participation in the next war, which is as inevitable as the last war. President Coolidge publicly declared in April, 1927, that the American domain extended over American property abroad. There is obviously only one way to make effective our domain over American property abroad and that is along the lines followed by us in Nicaragua or by the Japanese in Manchuria. President Coolidge was defending our warfare on General Sandino, which has cost 100 American lives and 3,000 Nicaraguan lives, to no useful purpose, when he laid down this amazing new doctrine. There is no reason why we might not in a near future see American troops fighting in Germany in an intervention to protect our investments there from communism, fascism or what not.

Most advocates of more international cooperation may be divided into two broad classes: First, there are those who are unable to define a program of world cooperation, other than to say that all nations should work together for peace, which is exactly what all nations maintain they have always done. Second, there are those who feel that we are our brother's keeper and should always be ready to join in any cooperative undertaking to make him do what is thought best for him. The argument underlying this school of thought is that whenever Poland sneezes, the United States must have a cold and ought to do something about it.

Let us now consider the fruits of our international cooperation since 1916 to determine whether they justify the claims of the cooperationists. Towards the end of 1916, while a simple, American folk were innocently reelecting him because

they thought he had kept us out of war, Mr. Wilson, with the highest of motives, was cooperating with Allied statesmen and New York bankers with a view to signing the death warrant of 50,000 American soldiers. Thus began our cooperation with Europe, which has been in unhappy progress ever since.

When Mr. Wilson sat down at Paris to cooperate with the victors, he made his country morally a party to a peace which today seems as certain to be undone by war as anything in the future can appear certain. We triumphed in a military way along with our "associates." So far from making the world safe for democracy, we have made it safe for more numerous and oppressive dictatorships than were known in all the hundred years since the fall of Napoleon. Our soldiers died in a war to end war. Never have preparations for the next war been more impressive or costly than in the post-war period.

The man who fought for a rose, a lily, a tricolor, for a cross or a crescent, for a chrysanthemum or a dragon, or quite simply for his home has known what he was fighting for. The American who went to war in 1917-1918 was deceived as to the purposes of the war. Subsequent evidence shows that even Mr. Wilson was deceived. Internationalism since 1916 has been founded largely on misrepresentation.

During the post-war period our cooperation with Europe has been on the front page most of the time. What fruits has it borne? In the German situation our cooperation has elicited great praise and two billion dollars, most of which now seem as good as lost. What have been the results? Goodwill for the United States? Economic rehabilitation for Germany? Better feeling between Germany and France? Promise of peace for the future? Hardly. France has been enabled to collect a heavy war indemnity and our allies to pay war debts to the United States Government. These are the only positive achievements. What virtue have they?

We have maintained—up to 1931—a twelve-year fight for the sanctity of war debts. During this period we have sponsored an international pact, supposedly outlawing war. American laws that outlaw gambling outlaw gambling debts. But, in

the American thesis, war had to be made safe for neutral profiteers. The gambler's code makes gambling debts, debts of honor. The American code makes war debts sacred. And the average American feels quite self-righteous about this American attitude.

Our financial cooperation has made it possible for us to carry our point on war debts and at the same time for Germany to effect indemnity payments to the victors, thus maintaining two prime encouragements to future wars: war debt payments for the profiteers and war tributes for the victors. American investors who have put up the money for these two series of transfers have been led by our government at Washington and in Wall Street to feel quite virtuous about these investments.

Moreover, our financial cooperation in Germany has treated that country to a five-year spell of unhealthy profiteering and inflation, with the inevitable dénouement of the now pending German bankruptcy. In 1924, Germany was only in default on her financial obligations under a preposterous peace treaty, the modification of which would have had to follow the failure of the French occupation of the Ruhr, had it not been for the intervention of American bankers and American investors, encouraged by an American government which sought to obtain war debt payments willy-nilly.

After six years of American financial cooperation, at the end of 1931, Germany was all but in name in default on over 6 billion dollars of commercial debts contracted with foreigners since 1924 and was quite as incapable of paying reparations as in 1924. All of this any sane person who took a disinterested view of the situation in 1924 was bound to foresee. The incapacity of Germany to pay reparations, then or ever, was amply proved in theory and by statistical arguments from the time of Mr. Keynes' first utterances on the subject. But insincere statesmen, mainly in America and France, together with banker subsidized scholars, have falsified facts, prostituted their intellectual integrity and deceived the people in sustaining a contrary thesis, which events have at last proved conclusively to be false in every particular. In 1924, when American

bankers and investors saved Germany through a noble piece of international cooperation, there were under a million unemployed in that country. By the end of 1931, after seven years of American cooperation and the "productive" investment of 2 billion dollars in Germany, that unhappy land had 4,700,000 unemployed. These are facts.

Our financial cooperation has only served to complicate a relatively simple Franco-German impasse of 1924 with the claims of American private investors, who, in 1932, will doubtless wish to inject their claims into a European situation in which the United States should have no intervention. Instead of proceeding against their bankers for having deceived them as to Germany's economic capacity and as to the plain terms of Article 248 of the Treaty of Versailles as to the priority of reparations over German commercial debts, a thesis properly sustained by the French, American investors will want their government to compromise American lives in the making of unwarranted diplomatic intervention in a Franco-German feud which is older than the American nation.

On the political side, it is evident that American financial cooperation has contributed powerfully to the collapse of the moderate parties in Germany and to the rise of the Hitler movement on the right and the communists on the left. American bankers and American investors have done this not only in Germany, but also in Chile, Peru and other parts of South America where American bankers have been proved by published evidence to have paid graft in connection with loans offered to American investors.

If it is easy to point out the evils which have flowed from American cooperation since 1914, it is no less easy to outline a constructive, 100 per cent American, policy which we might have followed to our national safety, dignity and advantage had our destinies been guided by the policies of Washington and Jefferson instead of the internationalism of Mr. Wilson and the international bankers.

In the first place, we should have refused to protect trade with the belligerents or neutral countries adjacent to the

theater of operations. We should have held that exercises of military authority affecting our traders trafficking with the belligerents were not aimed at us but against one of the belligerents. These measures we might have deplored but considered non-preventable. The fact is, we did not prevent them. We merely avenged them.

On the ground of self-interest, we should have deemed it more advantageous as a nation to acquiesce in exercises of military authority we could not prevent than to go to war to avenge, but not prevent, them. On the score of honor, we should have considered our honor unsullied by acts which were directed against belligerents and which affected impartially all neutrals having commercial intercourse with them. On the point of honor, we should have taken the sensible position that it was absurd to pick a fight with one belligerent, when both parties were denying the rights of our traders on the high seas. The fact that the exercises of military authority by one belligerent were more harmful to the lives of our traders than the exercises of military authority by the other party would not have been deemed material. The Germans disavowed any hostile purpose against us and offered compensation for the victims of their military measures against goods destined to their enemies. A Jeffersonian embargo would have been a simple means of avoiding all difficulties and keeping us out of the war.

It is absurd to argue, as is often done, that if a neutral does not announce a will to avenge all interferences with its traders, their trade will be seriously curtailed. It would have been better for us had our war trade been curtailed by about 90 per cent or whatever amount we sold on credit. The fact is that an absolute denial of protection, such as Mr. Bryan wisely favored, would not have curtailed seriously the amount of goods sold to the Allies for cash. If risks and losses killed trade, there would be no bootlegging in the United States and there would not be thousands of speakeasies in New York City. The only measure by which the American Government could have definitely curtailed war trade would have been an

embargo on credit to the belligerents. An embargo on cash sales could have been only fairly effective.

A neutral has a valid grievance and even a cause for war when a belligerent exercises military measures which deprive the neutral of needed supplies. We never even intimated such a grievance. Fighting, as we did, for the right of neutral traders to sell supplies—mostly on credit—to a belligerent, we avenged the German challenge to our traders' right to profiteer on war trade, financed by American credit. It was cooperation with the Allies during our neutrality.

In the second place, we should have allowed no loans or credits to be publicly offered or to be made privately by institutions under government supervision to finance exports to the belligerents. We should thus have denied American manufacturers the profits on some 16 billion dollars' worth of American goods sold for foreign I.O.U.'s, 11 billion of which are constituted by paper held by our government and soon to be canceled. We should also have deprived American producers of the profits of some 25 billion dollars, in addition, spent by the United States Government on its participation in the war. This would have been sad for American manufacturers and farmers had there been no other way of enabling them to make these profits, without selling on credit to the Allies and getting ourselves into a European war. But there was another way.

Had statesmanship of the types exemplified by Washington and Jefferson and not financial interests ruled our destinies at that time, we should probably have found the other way. In following a 100 per cent American policy, we might have proceeded on one of two assumptions about the belligerents. We might have assumed that when they had fought it out, the winners, or both sides, would come three thousand miles across the sea to attack us for no other reason than our neutrality. Or, we might have assumed that neither side would seek an unprovoked war with us after a long struggle in Europe.

Acting on the first assumption, we might have spent the 16 billion dollars we lent in supplies to the belligerents on the

expansion of our army, navy and coast defenses. If started by the end of 1914, such expenditures would have made us by the end of 1917 invincible against any conceivable attack by the war weakened European belligerents. The Swiss, during the war, put on war footing an army which would have made any attempted invasion of Switzerland far more costly than its success would have been worth to either belligerent. These measures did not involve the Swiss in the war. Preparedness does not cause wars, nor does unpreparedness avert them. Had we taken such impressive preparedness measures, we should probably have saved the American lives sacrificed to no useful purpose on the altar of a misguided internationalism. The gesture would have shortened the World War and resulted in a more moderate and healthy peace.

Proceeding on the assumption that we had nothing to fear from the belligerents, however their troubles turned out, we might have constructed some 16 billion dollars' worth of public works and launched a series of social expenditures to create the same acceleration of activity that the war caused. Today we should have most of the properties intact instead of bundles of worthless foreign credits.

Had we thus minded our own business, it is not unlikely that Mr. Wilson might still have been invited by both sides to preside as a sort of arbitrator at a peace conference which would have resulted in a drawn peace. Lending money to belligerents to buy munitions, joining holy wars and lending losers money to pay indemnity are, undoubtedly, acts of international cooperation, but there are other ways of cooperating. The point is that international cooperation, as an ideal or end in itself, is a mischievous fallacy. Rascals often cooperate while honest men fall out with each other.

A plea for international cooperation usually indicates a bid for supporters for some school of thought or plan of action. With modern Americans it is better advertising strategy to ask them to cooperate than to try to explain the object of the cooperation. The ideal of cooperation having already been conditioned into their behavior responses, an appeal for co-

operation without any explanation of objects relieves Americans of the necessity to do any thinking, an exercise which is peculiarly disagreeable to them. A speaker has only to say "international cooperation" several times in the course of a perfectly meaningless speech to secure the warm sympathy of his audience. These words are like the flag or religious symbols; they evoke unreflecting responses.

Realists understand that the entire world is not likely in any near future to be of one mind, not even that of the United States. Some realists are glad of it, because they would heartily dislike to live in a world in which everybody agreed and hence cooperated with each other all the time. The realist is further aware that the best known way to start a big war, or to make a small war big, is to preach a crusade for a true faith.

A sincere and eminent pacifist, Senator Borah, in an address at Boise, Idaho, on August 14, 1931, asserted that the French demand for security, if carried beyond the security the nation already had through the treaties and military power she enjoyed, "can mean nothing less than the destruction of Germany, Austria and Hungary." "And that," speaking for whom it is not altogether clear, Mr. Borah added, "the world will not consent to see brought about." It is the statesman who will not consent to see something or other done by one nation to another in Europe who is most likely, sooner or later, to send hundreds of thousands of Americans to their death on European battlefields—Americans who will not be too old to fight.

The "destruction of Germany" could not mean, even in Senator Borah's imagination, the putting to death of the entire German population or the obliteration of the works of man in German territory. At the worst, it could only mean that France might do to Germany, Austria and Hungary what these countries have repeatedly done to weaker peoples in no remote past, or what we did to Mexico in 1849. It is perhaps fair to say that most Americans, if given an opportunity to express a choice uninfluenced by war hysteria, would rather see the "destruction" of Germany, Austria and Hungary than the sacrifice of one good American life in an attempt to stop it.

And, vice versa, the 100 per cent American would rather see the entire French nation goose-stepping to "Die Wacht am Rhein" than 50,000 American graves in France. After all, what business is it of ours who conquers whom outside of the Americas? Other nations have certainly shown us the same courtesy of non-interference with our numerous private wars and conquests in this hemisphere.

Another bellicose lover of peace, Mr. Oswald Garrison Villard, in the August 12, 1931, number of his publication, the *Nation*, of New York, wrote an impassioned article entitled "France against the World." In it he said, "Every move now being made to revive Europe encounters French opposition." Mr. Villard quoted approvingly Arthur Henderson's declaration before the Socialist International at Vienna on July 28, 1931, that "We shall proclaim every government which opposes disarmament a deadly enemy of mankind." Mr. Villard, however, was mistaken. France is not against the world. She has at least five treaty allies: Belgium, Poland, Rumania, Czechoslovakia and Jugoslavia. They are all cooperating beautifully with French policy. All that is needed now for a good war is a little cooperation among a few nations feeling as Messrs. Borah and Villard express themselves on the subject of French policy.

Possibly France merits the moral censure of these gentlemen, and then, possibly, she does not. A realist must have some respect for the opinions of Frenchmen who have seen their country invaded twice in one lifetime and who also read the present German propaganda of revenge. The opinion of American statesmen who never smelled powder as to French security is somewhat incompetent. Our bankers have over 600 million dollars frozen in short term German loans, and our investors have nearly 2 billion dollars in German investments. But these are not reasons why American bankers and statesmen may dictate French policy towards Germany. This policy has changed little in its fundamentals during the past two hundred years, whether under a kingdom, commune, directorate, consulate, empire or republic. In so far as Messrs. Borah and

Villard point out that this policy has not changed since the war to end wars, they are entirely correct. If they or anyone else in America imagines that American cooperation in European wars or intervention in German finances can modify the traditional relations between France and Germany, they are sadly mistaken. We can always get into a Franco-German war, or almost any other war, but we cannot change the leopard's spots. Those who object to French policy in 1931 should have thought of these objections in 1917 or when we were making our loans to Germany. French policy towards Germany has undergone no material change for two hundred years.

If France and her allies persist in policies displeasing to our bankers and to Messers. Borah and Villard, there is ultimately one way to stop it. That is the international cooperation way used by Russia, France, Britain and, finally, the United States to check Austro-Hungarian policy in Slavdom. The ruling powers of England ought to have done some deep thinking in 1931 as to whether Great Britain might not have enjoyed a longer life as a great power had British statesmen back in 1900-1907 decided to do less cooperating to thwart the fulfillment of German and Austrian ambitions in eastern Europe. The British made a great play of saving Belgium and Serbia, but just who is going to save Britain in the near future?

The international cooperationist, of course, has immense reserves of moral indignation over the wrongs of foreign peoples, though he can keep remarkably cool about six millions of unemployed Americans or six millions of American farmers having an average income of $425 in 1930. Once the international cooperationist has passed a moral judgment on a foreign country, he is ready to proclaim a holy war, line up the liberals and pacifists, and call for international cooperation to save somebody and something from somebody and something else. Just at present the League of Nations is the instrument through which the bellicose lovers of peace propose to have their will done on earth.

The author of this book is ready to fight at the drop of the

hat in defense of his native land. He will also fight in all its wars whether he believes in them or not. He is an American and a nationalist. He volunteered and served as an officer of infantry in France during the last war, American participation in which he considered wholly unjustified and wrong at the time. If he is not too old, he will similarly volunteer to fight in the next war, which, however, he feels fairly certain he will not approve of. As he will keep silent and obey orders during that war, he is taking this opportunity to express his opinion of it, while speech is still free and such an expression of opinion can not be said to be disloyal. That war he sees as inevitable and as the creation of the American international cooperationist who is eager to get into a fight over almost everything in the world except his own home. This book stands for smaller wars! The cooperationist says he stands for peace. Before long he will probably be fighting for it. In reality, he stands for bigger and holier wars.

CHAPTER XVIII

COOPERATIVE MANAGEMENT OF GOLD AND CREDIT

ALTHOUGH war is the only large enterprise at which nations have ever successfully cooperated for a considerable length of time, the cooperationists prefer to talk of international cooperation in the economic field, particularly in finance. So, in this chapter it is proposed to develop three points. The first is that gold and credit must largely manage themselves under capitalism; that is to say, they must be managed by the play of innumerable economic factors, domestic and foreign, over which no central bank—not even the Soviet dictatorship in Russia—can exercise control.

The second point is that the financial institutions are arts which must develop according to the individual peculiarities of different peoples and be expressive of their cultures; hence, these institutions can never be reduced to a science or rendered susceptible either of standardization or of cooperative practice.

The third point is that the operations at times said to constitute international financial cooperation are only incidents of a perpetual international economic war, of which armed conflicts are but the recurrent military phases.

Now, as for the first point that the gold standard must manage itself: If the international commerce of a country is in a proper state of balance, the demand for and supply of gold or gold exchange in that country will always clear the market at rates of exchange within the gold points. Seasonal demands for gold will not exceed the offer of gold or gold exchange to a greater extent than the reserves of the central bank can safely satisfy. If, on the other hand, the international commerce of a country is not in a proper state of balance, the net demands for gold will exhaust the reserves of the central bank, however large they may be, and force the currency off the gold

standard. There is absolutely nothing a central bank can do or ever could do to assure the proper state of equilibrium of all the factors, national and international, affecting the demand for gold in exchange for national paper currency.

These factors are as numerous and uncontrollable as the economic life of the entire world. If a central bank exercised the same measure of economic control that Mr. Stalin commands in Russia, the central bank could be said to manage the domestic factors affecting its gold, credit and currency. But even Mr. Stalin cannot so manage these factors as to stabilize the exchange value of the Russian currency in relation to gold in a free world market.

The functions of a central bank are, as a matter of fact and not of fiction taught by academic experts looking for large fees, much simpler than is commonly supposed. The bank converts the national money into gold or gold exchange as long as it can and stops when it can't, and that is about all there is to it, whether it be the Bank of England or the Central Bank of Bolivia. If the owners of 10 per cent of the deposits in the banks of the United States, for any reason whatsoever, decided to try to convert this amount of money into gold or foreign currency, the United States would go off the gold standard within twenty-four hours. It is just that simple. There are a little over 50 billion dollars on deposit in the banks and around 4½ billion dollars of gold in the country.

Before the war the international trade factors were in a fairly constant state of balance. Gold was not hoarded to any considerable extent by central banks except in Russia. Gold circulated freely as currency all over Europe. There was no gold or credit management worth mentioning, though at times the Bank of England made changes in its discount rate suggested by obvious changes in the balances of the English banks and the flow of gold. These acts of the Bank of England were extremely effective in that situation. The mechanism may be likened to a drawbridge weighing several thousands of tons, so evenly balanced that a ten-year-old child by depressing a five-foot lever can lift the bridge. The child is neither a Her-

cules of physical strength nor a consummate artist in the management of gravity. The mechanism explains everything. The act of the child is obvious, easy and insignificant.

In the pre-war situation world trade was largely financed through 90-day sterling bank and trade bills on London banks and bill houses and merchants. These bills were dealt in by bill brokers. They were bought by banks all over the world as investments running from a few days to 90 days. These bankers could be sure that sterling would be worth between \$4.8790 and \$4.84, the points at which it was profitable to import or export gold, respectively. If gold began to flow out of England, the Bank of England had merely to raise the discount rate to attract an inflow of funds from all parts of the world. This inflow would at once stop the outflow. All this took neither science nor great artistic skill. It required a special set-up, a proper world balance in trade, and the touch of a child's hand.

In June, 1931, the Bank of England could have raised the bank rate to 20 per cent and gold would only have flowed out of England the faster. The point is that the old set-up has been destroyed for ever. Since the war, commerce has not been mainly financed by sterling bills. It has been financed largely by telegraphic transfers on New York disposing of the dollar exchange, proceeding from imports into America and American loans, the short term credit operations, where such occurred, taking the form, usually, of commercial letters of credit opened by banks in favor of importers. In America a naïve attempt was made by the American Acceptance Council to introduce into American practice the British acceptance form of financing, not only for foreign but also for domestic trade financing, which is done in this country mostly on open account. These attempts have had little success, largely for the reason that will be explained in the next point: financial ways are arts peculiar to a people. A country of small banks can never use acceptances to the same extent as a country of large bank chains.

The main reason why the pre-war financial machine operated

by London is busted is war debts. Before the war, the debtor countries were mostly exporters of raw materials for which there was usually a good demand. International payments were met with exports of goods, gold and services. The foreign debts of the Napoleonic Wars were relatively small and were canceled outright in largest part by the chief creditor, England. Thereafter, no large debt problems arose to curse mankind until the billion-dollar French indemnity paid to the Prussians in 1871. But this amount was less than one-fourth the value of French foreign investments at the time. Moreover, at the end of the brief Franco-Prussian War French credit was excellent. It was, therefore, extremely easy for France to mobilize, either from her foreign owned assets or her credit with foreigners, the means of paying promptly this indemnity. Professor Jèze of Paris has shown to the last franc exactly how and where the money was found.[1] It was all simple and obvious. A German indemnity of two to five billions in 1919 could have been liquidated with similar despatch.

Now talk about managing debts is largely bunk. Debts call for one of two things: payment or non-payment—not management by cooperators, college professors or other experts in financial mystification. War debts and reparations never could be paid and never can be paid, and that is all there has been to the major factor creating disequilibrium in world trade since Versailles. The debts could be paid for a time by dishonest loans founded on a fundamental lie. In the process of inspiring confidence in that lie, cooperation was most useful. The play of compound interest has finally put an end to that method. Cooperation cannot defeat compound interest.

Experts who have spent a lifetime studying the pre-war financial machinery are about as useful as individuals who have acquired a similar proficiency in heraldry, medieval magic or canonical law. French post-war monetary policy has been wise and successful precisely because French politicians have done what they wanted, in their own way and untrammeled by the counsels of experts trying to apply rules developed in a situa-

[1] La Technique du Credit Public, Gaston Jèze, 1925, pages 337-344.

tion which had ceased to exist. The British have steered straight into financial disaster because they have not been intelligently realistic. It is useful to know how things were done ten years ago or ten thousand years ago. But it is much more important to have the intelligence to see how things have to be done today. This is an intelligence rarely possessed by experts who have spent their lifetimes studying the technique of an extinct art or craft.

Space does not allow of an adequate historical analysis of central banking to demonstrate its wholly empirical character. A few historical notes from H. D. Macleod's standard text, *The Theory of Credit,* are offered for the consideration of believers in economic revival by central bank policy and who plead for international cooperation to this end. Macleod, it should be stated, was, himself, a firm believer in the practicability of central bank control of credit and exchange through the simple manipulation of the discount rate,—provided, of course, the institution were properly conducted, which is to say, according to his ideas. He was, therefore, not prejudiced against central banks.

With regard to the origin of the Bank of England, Macleod wrote,[2] "William Paterson, a Scotchman, (clergyman-soldier of fortune) whose antecedents were gravely suspected, and who was afterwards so notorious for his Darien scheme which ruined half Scotland, but who had travelled widely and studied foreign financial institutions, proposed several schemes which proved abortive. At last, one succeeded." Thus the Bank of England, the mother of central banks, came to be founded in 1694 to furnish the British Government with a loan of £1,200,000 for the war with the French and to make money for a group of London tradesmen, who took up one of Paterson's many ideas. Macleod continues,[3] "The Bank was a Whig project and had been eminently successful in supporting the Government in the prosecution of the War."

[2] Vol. II, page 527.
[3] Vol. II, page 532.

The Bank of England was founded about a decade before the rise of Lawism. Macleod points out that the doctrines of John Law took three forms:

The first form of Lawism was the issue of paper money on the security of land, as in the disastrous Ayr Bank experiment. John Law held that paper money might be issued to twenty times the amount of the annual land rent. A realist still asks why twenty instead of five or one hundred? The error of trying to correlate a monetary standard with land or any series of economic goods is evident. The government can, by law, define a dollar as so many grains of fine gold or as a certain piece of paper. This definition holds until another law establishes a new definition for the term, a dollar. A dollar is merely a legal definition. Government can, by law, also make the thing it defines as a dollar legal tender for the payment of a debt of one dollar. No law or act of man, however, can ever establish the future value of gold, paper, or anything else in a world of free exchange. There can be no permanent standard of value for two reasons: First, value is only the quantity of one thing people are willing at a specific moment of time to give in exchange for another thing. Economic value can only exist as a ratio in a specific act of exchange. Second, people will value goods differently at different times.

The second form of Lawism was the issue of paper money based on the discount of mercantile bills. This doctrine is one of the ruling principles of our Federal Reserve System. The principle has this important weakness: No commercial bill of exchange can furnish an economically sound basis for the emission of paper money or its equivalent in central bank credit unless the bill is generated by a successful or profit-yielding operation. So far, no one has evolved a formula for determining, at the time a commercial bill is offered for discount, whether the operation on which it is based will yield a profit. Credit can be regulated according to a given ratio with a metallic base, as gold, but not according to hindsight, which even bankers possess only after the event. As yet no one has proved the validity or even usefulness of any ratio of gold to credit.

The issue of central bank notes or credit on the discount of commercial bills must, therefore, be as empirical as fortune telling.

The issue of paper currency on public securities, usually war debts, was the most important tenet of Lawism. This obviously was the principle on which the Bank of England was founded and the principle to which our Federal Reserve System was turned during the World War.

Macleod wrote,[4] "When, therefore, some persons may be inclined to sneer at Law and anathematize all his works, let them remember that the Bank of England was founded on one form of Lawism, before Law had ever been heard of, and continues to be so."

Writing back in the eighties, Macleod pointed out, "As soon as I came to examine critically (in 1855) the Bank Charter Act of 1844 (modified in 1914, 1925 and 1928) and the ideas, concepts, and theories upon which it is founded, I saw at once —as every mercantile lawyer would,—that its very basis, the definition of currency, upon which it is founded is absurd; and is in diametrical contradiction to a whole series of decisions of the courts of law and the doctrines previously held by all statesmen and economists. . . . The fact is that the Bank Act of 1844 is founded upon a whole nest of definitions and theories which are pure moonshine."

The Bank of England, nevertheless, was conducted with considerable success, marred by several monetary panics, during two centuries of British prosperity from monopolies in shipping, manufacturing and banking. That prosperity has ended and the old lady of Threadneedle Street will never be the same again; nor will the pound sterling.

In times of war or economic depression, statesmen turn to the central bank to apply the principles of John Law with due solemnity and mystery. There is a strong and irrational prejudice against the achievement of the same results by direct government operation of the printing press. It seems obvious

[4] Vol. II, page 667.

at the opening of 1932 that the printing press of the Federal Reserve System will ultimately have to provide for the absorption of our federal government deficit bonds, exactly as it made possible the sale of our Liberty bonds during the war. There is this difference, however, to be noted: European gold flowed in after the war to support our war inflation but it seems not unlikely that much of our gold will flow out to Europe as our Federal Reserve Banks proceed to finance our deficit with the printing press.

It is evident that central banks can run the printing press to finance wars or to supply credit when anybody wants credit for any purpose. It remains to be shown how central banks can generate economic activity or maintain economic stability. For instance, between February and July, 1931, the total volume of Federal Reserve Bank credit hovered between 900 million and a billion dollars. The months October to December of the same year saw the volume of Reserve Bank credit inflated constantly around 2 billion dollars, the figure attaining the total of 2,212 million in October, 1931. Did this opportunistic doubling of Reserve Bank credit serve any useful purpose?

The answer is that while our central bank credit was being inflated 100%, common stock prices declined over 50%, bond prices about 20%, industrial production about 20%, wholesale prices over 10%, and, in fact, nothing went up except the number of bank failures, bankruptcies and the unemployed. Even loans by the member banks of the Federal Reserve System declined from 22,840 million dollars on March 25, 1931, to 20,874 million dollars on September 29, of the same year.

The realist still awaits theoretical demonstration or historical verification of the claims of the believers in economic deliverance and leadership by the central banks. It would appear to him that the alleged successes of central bank management have always been those of the industrial revolution, of the settlement of new continents with rapidly growing populations, or of the indomitable will of a mighty people to prosecute a war. The dynamic factors generating economic activity

are spiritual and not the properties of monetary mechanisms, and their guardian mechanicians.

We now come to the second point, that the financial institutions are arts which must develop according to the individual peculiarities of different peoples and be expressive of their cultures. Let it be said here that it is of the essence of financial operations that people get together, parley, negotiate, make contracts and exchange each other's negotiable instruments. All of this may be described as cooperation to simple minds for which the term "cooperation" has a strangely grateful sound. Intelligent realists naturally are interested in the human motives and forces behind these obvious operations of commerce and parley.

In the field of central banking, or the management of gold, money and credit, splendid examples of cooperation are supposed to abound. The MacMillan Committee in its report of June, 1931, pointed out the need for, and the possibilities of, the right sort of international cooperation by the central banks of the different countries. The objectives would be the maintenance of the stability of international price levels over long periods, the regulation of the volume and terms of bank credit at home and abroad, and the management of the world's 12 billion dollars of monetary gold for the best interests of all concerned. All of this sounds splendid. But as soon as one gets down to brass tacks, one finds the members of the MacMillan Committee, itself, at sixes and sevens with each other in a series of violently dissenting opinions.

The majority of the Committee was dominated by the thought of Mr. Keynes, one of the members and, probably, the world's most original and dynamic thinker in the field of economics. The majority of the Committee, therefore, disagreed with the findings of the Cunliffe Committee, another aggregation of experts on whose recommendation England made the great blunder of reestablishing the pre-war parity of the pound sterling. Mr. Keynes had to write a pamphlet entitled "The Economic Consequences of Mr. Churchill" to say all that he felt about that blunder. It turns out that Mr.

Keynes, in spite of being an expert, was right. In France, where politicians handled the currency in their own inflationist way, to the horror of British deflationists and currency experts, it turns out that everything was done with great wisdom. The home of central banking, if not of modern deposit banking itself, not to include the cult of economics, is at present a sorry advertisement for the scientific currency expert. This chapter will proceed to rub it in.

Chiefest among the difficulties in the way of central bank cooperation is the simple fact that the experts in every art disagree quite as much as the amateurs. Experts are helpful as consultants only in the field of science. In the home of modern banking, the experts have repeatedly proved each other guilty of egregious blunders and gross incompetence. But should anyone ask an artist to be right? One asks him to create something, and then one likes it or one doesn't. That is about all there is to art. There are craftsmanship and technique in art, but they are unimportant except to the artist himself. The Wall Street and Lombard Street credit artists have never practiced an exact science.

It is not surprising that the South American countries which received the ministrations of Professor Kemmerer and his touring financial experts are now bankrupt or on the verge of bankruptcy. Of the Kemmererized countries, Chile, Peru, Bolivia have already suspended debt service, while Colombia was on the point of doing so at the end of 1931. Ecuador did no borrowing during the halcyon years, largely because it had not arranged a settlement of an old defaulted bond issue.

Of course, Professor Kemmerer's services have not been responsible for the defaults. They were, however, helpful in selling the bonds now in default. It may be said that all the recommendations of the Kemmerer experts were not faithfully carried out, but it must be admitted that a great many of them were. Certainly Professor Kemmerer's drafts of model laws were enacted and his model institutions, such as central bank, comptrollership and budget office were duly set up and made to function, though, perhaps, not perfectly. The most important

thing the Kemmerer missions did in most of the countries which they served was to help bankers to sell too many of the bonds now in, or on the verge of, default to American investors who were led to believe that a three months' visit of a team of itinerant experts could produce an improvement in the financial ways of a nation. By thus facilitating the sale of excessive quantities of bonds, beyond the means of the borrowing governments to serve at a normal level of prices, these missions encouraged unbalanced budgets, excessive expenditures on credit and overproduction of raw materials. Subsequent misfortunes have been the work of a return of prices to pre-war levels and a return of the incomes of the borrowers to normal.

In its argument for cooperation between central banks the MacMillan Committee gives its whole case away in one short sentence: "The management of currency and credit is essentially an art and not a science." An art cannot be revealed to a foreign country in the course of a three months' visit of a band of strolling experts nor yet can it ever be the subject of international cooperation. An art must be developed by long years of practice. Furthermore, any art will be practiced differently by different peoples and never according to an international plan. There can no more be international cooperation in the practice of the financial arts than in the arts of cooking omelettes or painting landscapes. Every nation must develop its own peculiarly national art. A people must express itself in its banking art as well as in its plastic art. Fortunately all countries did not express themselves in the financial arts as England has done in the past ten years, or as the clients of American college experts and bankers have done. For men trained in English and American political institutions and common law to draft laws for countries whose laws and culture are based on Roman law and an entirely different heritage is ridiculous except for the purpose of helping the sale of bonds to American investors.

Many people, not of the international cooperationist persuasion, are rather glad that arts are expressions of national and personal individualities. For many people it would be a

dismal world if the arts ever became so standardized that international cooperation in their practice were to become as feasible as it is in the use of an American adding machine. It would be depressing to these people to find an art so reduced to one pattern that American professors could inculcate it in the practitioners of different countries in three months' periods at $75,000 an inculcation. Of course, every lover of art would have applauded the development by American experts of a worthy native art of public finance administration, say, in New York or Chicago. Art, like charity, should begin at home.

As a matter of fact, wherever there has been public mismanagement, whether in South America, Mississippi, Chicago or Great Britain, there has always been any number of highly competent natives in and out of the local universities who have known perfectly well what was wrong and how to right it. It was never necessary to import professors to tell a government to balance its budget. It was, however, useful for bond selling.

The financial breakdown of Great Britain in 1931 has been far more serious than any situation which American financial experts were ever called in to straighten out, but, so far, there has been no mission of American experts sent to teach Great Britain the ways of sound finance. The alibi of the British experts is that the rest of the world, notably the United States and France, did not cooperate. And this brings us to consideration of the third point stated at the opening of this chapter, namely, that finance is a field of international conflict.

The point of the reply to the British alibi is this: What reason can any nation ever have, other than a wish, for expecting the world to play any competitive game to suit its interests? The fact that the thesis of international cooperation is based on this absurd expectation is the essence of its fallacy.

A nation which makes its prosperity, if not its existence, dependent on a desired course of behavior by foreign nations is insecure. Of course, British policy was not developed in any such naïve belief as that the world would cooperate with its plan, all as a matter of playing the game. Before the war the British manufacturing, shipping and banking monopolies

needed no foreign cooperation and feared no foreign competition, though they were beginning to be crowded a little by Germany in the years just prior to the outbreak of the war. To talk about the cooperative features of the pre-war British banking system because international bankers recognized each other's signatures is palpably absurd.

Now that the pre-war situation has departed, largely as a consequence of the war, England has had to depend for her prosperity on what is called international cooperation in the management of central bank credit, gold reserves, foreign investments and tariffs. All of this merely amounts to saying that the American Congress, the Federal Reserve System and the American investor should have conducted their affairs to suit the British bankers. As the cooperationists would say, they have not cooperated. But why should America cooperate with its chief shipping, banking and naval rival? We have been out to beat England, to wrest her foreign trade and banking from her, and to dispute with her every possible advantage in foreign commerce. Any nation that is dependent on the cooperation of her rivals is out of luck as the British are now, perhaps, learning.

The United States Government should have canceled all our war debts as Great Britain intimated in the Balfour note. This would have averted most of our post-war accumulation of gold and foreign loans. Without this gold we could not have had our speculative boom and the stocks of certain large New York banks could not have appreciated 1,000 per cent in ten years. On the other hand, Great Britain, having a larger share of the world's gold in a more normal course of trade and gold movements, could have made more loans abroad, thus financing larger exports of British manufactures and reestablishing her financial power. In 1927 British trade with Latin America showed a gain of 26 per cent and British investments in Latin America a gain of 18 per cent over the figures for 1913. The corresponding figures of increase for the United States were 118 per cent and 349 per cent, respectively. The United States did not cooperate with the British after the war.

Once we maintained the claim to our pound of flesh on war debts, we might still have cooperated to some extent, by lowering our tariff and taking full payment on our foreign credits in the form of a commodity imports surplus. This process would have crippled American industries and made those of our debtors to flourish, all of which would have been cooperative on our part. The mechanics of this process will be explained in a later chapter, entitled Can Foreign Loans Be Repaid? They can be only if the creditor is willing to suffer industrial stagnation while the process creates industrial prosperity for the debtor.

We were not cooperative. Congress claimed war debt payments and protected our industries. Under the guidance of the international bankers, our investors did cooperate to a considerable extent by lending the interest on our loans, but these loans were not enough. Moreover, the amounts involved grew so large that the necessary compounding loans could not be kept up. Worst of all, perhaps, our Federal Reserve Bank of New York so managed credit as to allow a wild speculative boom, aided by our redundant supply of war-gotten gold.

The whole case against financial cooperation resides in the fact that the entire world will never play the competitive game to suit the interests of the nation that has been so foolish as to make its economic life dependent on foreign trade. Let us extract from recent financial history further proof of the proposition just stated.

Early in June, 1931, the banking situation in Austria began to look murky with the impending collapse of the *Kreditanstalt*. The president of the National Bank of Austria announced an increase in circulation of $31,000,000. On June 14, a committee from England, headed by Sir Robert Kindersley, a director of the Bank of England, went to Vienna to examine the *Kreditanstalt* situation and "cooperate." The Bank of France, which was also "cooperating," made two important demands as a condition of giving assistance. These demands were: first, that a full inquiry be made into the economic situation of Austria; second, that a formal renunciation be made of the

customs union between Germany and Austria and any modification, whether political or economic, of the relations between these two countries. These demands were not well received at Vienna, and they made a bad impression at London and Berlin.

While the negotiations were thus hanging fire and the Austrian situation daily growing more critical, Sir Robert Kindersley announced from Vienna that the Bank of England had decided to advance $21,000,000 to the Austrian National Bank, the Austrian Government, humorously enough, guaranteeing the liability. This credit relieved a stress at Vienna but started things at Berlin and a little later at London. French banks had over a half billion dollars on deposit with English bankers, who in turn had the money loaned out in Germany at high interest rates. The financial screws began to turn noiselessly and before long the outflow of gold from Berlin and London showed clearly who were on the rack. Of course it cannot be said that the French withdrawal of gold from London dated from that moment. In 1930, France withdrew 267 million dollars net of gold from London and in the first eight months of 1931 she took another 234 million net from the Old Lady of Threadneedle Street. The Bank of England, of course, was forced to draw on her foreign resources for gold to meet these withdrawals. Between March, 1930, and September, 1931, France gained 658 million dollars in gold, 500 million of which came from England.

To continue with the narrative of financial cooperation between the central banks in June and July, 1930, it may be said that, following the failure of the British to support the French pressure on the Austrians to abandon the customs union with Germany, the Austrian Government fell, the Reichsbank lost 200 million dollars in gold in a month and the Bank of England subsequently lost no less within a similar period. Then began a little more "cooperation." Two credits of 125 million dollars each were granted by the Reserve Bank of New York and the Bank of France early in August to peg the pound sterling. These credits were quickly exhausted, but they gave the Bank of England time to mobilize more gold exchange to

feed into the maws of France, Holland and Switzerland. Further credits were needed to support sterling. It was then the foreign bankers forced the overthrow of the Labor Government and the formation of a Coalition National Government.

A second credit of 400 million dollars in favor of the Bank of England was opened by the bankers of the United States and France, which merely gave the Bank of England more time to mobilize more gold exchange for sale to persons withdrawing funds from London. Finally, of course, the fight for the pound had to be abandoned.

Returning to the events of July, 1931, we have to record an eleventh hour gesture by Mr. Hoover to relieve the German situation. The American press, which is trained to jump through the bankers' hoops, at once acclaimed this obvious though futile gesture, but their optimistic propaganda was hardly off the press and a mild favorable market reaction under way when the logic of events which could not be kept off the front page gave it the lie. The proposal simply amounted to an official recognition that reparations payments and war debt payments would not be paid from July, 1931, to July, 1932. In fact, they would not have been paid had the moratorium declaration not issued. The proposal really amounted to a forced loan by the creditors of Germany of money which American and foreign investors and bankers had up to 1931 been eagerly supplying to cover German debit balances. Germany received relief to the extent of about 400 million dollars, but, to call it a moratorium, is to show a lack of humor. It was the last of cash reparations and war debt payments, and an agreeable mystification for the German bankruptcy.

Mr. Hoover's gesture, however, was not treated by the French in a spirit of sympathetic cooperation with the objectives of the author. Mr. Hoover and the French were pursuing different objectives, which is the eternal explanation why international cooperation must be a thing of the imagination where vital interests are in conflict. Mr. Hoover was concerned with restoring confidence in Germany and thus keeping up the game

of lending more money to Germany to enable her to pay reparations and thereby supply funds with which to keep up war debt payments to the American Government. France, of course, has never been really interested in securing money or other payments from Germany. She has been concerned with keeping Germany just where French policy for centuries has always wanted to have Germany—in a state of confusion and military ineffectiveness. In other words, France was concerned over her security. Obviously no French statesman who was not a fool—and few are—would make a truthful statement of French policy in regard to Germany; and no foreign statesman who was not a fool would attach any credence to any formal statement of policy by a French statesman in regard to this subject.

Mr. Hoover's mental reactions are those of a worried banker who is always and only trying to carry on his business as best he can. The reactions of the French are those of a race of patriots who have seen their country invaded twice in one lifetime by German armies and who read in the German press today propaganda of revenge against France. Cooperation between the French and Mr. Hoover was, obviously, out of the question.

Inspiring foreign investors with confidence in Germany's capacity to do the impossible has been the technique for financing German reparations payments since 1919. First, the investors in 2 billion dollars of paper German marks financed the comedy; then came another school of fish to absorb the 6 billion of now nearly worthless German investments. But not 5 per cent of these victims were Frenchmen who received the lion's share of the reparations payments. Cooperation among bankers of different countries to represent a situation in a false light with a view to the sale of worthless investments should be called by its true legal term: a conspiracy to defraud. It has not suited French policy in 1931 to cooperate in this way.

The causes of shaken confidence in the British financial structure have been no more psychological or subjective than the reasons for seeking shelter from an approaching storm.

When the pressure on sterling began to be felt in the early summer of 1931, London bankers had upwards of a half billion dollars loaned out on short term to German banks. Deposits and sterling bills in London on foreign account ran upwards of 2 billion dollars of which nearly half was on French account. England owed the world and Germany owed England over a fourth of what England owed the world, on practically demand account. If Germany defaults, on the present standstill agreement, a general collapse of British credit seems practically inevitable. A collapse of British credit will involve considerable losses for foreign creditors or depositors of British houses, but it looks as though, on the basis of available data at the end of 1931, American investors and bankers would be holding the German bag to the extent of two to four billion dollars.

The terms "cooperation" and "confidence" have been greatly abused in connection with international finance. It needs no cooperation to tell the truth and none to disprove a lie. Cooperation is usually needed to put across a lie or to maintain its general acceptance.

When statesmen or bankers plead for the cooperative management of gold and credit, what they really ask is that these factors be manipulated in ways agreeable to the furtherance of selfish national policies and personal profit-making schemes. To be perfectly clear and definite, since 1915, so far as the United States has been concerned, international finance has been a nexus of processes serving mainly to finance the prosecution of war, preparations for war, and the payment of war indemnity and war debts. In the next chapter this statement will be adequately proved by appropriate analyses of our international balance of payments since 1914. Normally the financial institutions of any country will be conducted according to the personality and interests of its people. Finance is an art and not a science. When there is cooperation in financial policies of great moment, it will indicate an international combination of interests in the furtherance of some scheme which, usually, will have to do with war. Normally, there will be intense competition and conflict between nations in the man-

agement of gold and credit through their great financial institutions. The conflict of national interests will be waged largely through these instrumentalities. To the intelligent lover of peace, this healthy conflict of financial interests is never so alarming as the signs of large scale cooperation, for the latter must, invariably, mean war. The clink of gold to the discerning ear is as ominous as the rattle of the saber.

In conclusion, it seems appropriate to anticipate the charge that the thesis upheld would, if followed, lead to the termination of all foreign commerce. The charge is not founded. Financial arrangements to facilitate an international exchange of goods and services against goods and services are not attacked. Commercial credits which are paid off as rapidly as the goods are sold are also not criticized. The thesis does, however, as will be seen in the chapters on foreign investments, oppose the crisscrossing of foreign placements of capital.

The facts of this crisscrossing of capital movements may be stated in the following extract from the *Federal Reserve Bulletin* of August, 1931 (page 437). "While American investments abroad during the three years 1928-1930 increased by $3,100,000,000, $2,700,000,000 and $2,300,000,000, respectively, foreigners at the same time invested in America $2,400,000,000, $2,300,000,000 and $2,000,000,000 so that the net increase of American investments abroad was only $700,000,000, $300,000,000 and $300,000,000."

The realist sees in these movements proof of little cooperation and no advantage for society. British investors were placing their funds in American investments because they lacked confidence in their own. American investors were placing their money in foreign securities because they lacked adequate information and common sense.

The realist fails to see how the tension between European labor and European capital will be eased by replacing European owners with American owners. He perceives no cause for peace rejoicings in the fact that millions of foreigners can now blame American capitalists and managers for the running of their public utilities. As for efficiency, the realist knows of no

CHAPTER XIX

THE GENESES OF AMERICAN INVESTMENTS ABROAD: WAR AND COMPOUND INTEREST

THE important fact about our foreign trade since 1914 is not that it has been foreign. The really important facts about it are, first, that it has been war-begotten trade, and second, that it has been mostly credit financed trade. The fundamental argument of this chapter is that the war gave us a chance to sell some 16 billion dollars' worth of goods on credit, and that compound interest has been solely responsible for the subsequent growth of our war-gotten foreign assets.

The fault common to popular interpretations of our foreign trade and investments since 1914 is simply that of overlooking essentials and glorifying unessentials. War is the great essential. It took no sales effort to sell American munitions, raw materials or foodstuffs to people too busy killing each other to produce requisite or even normal quantities of these commodities. It took just one thing: credit.

Most of the sales effort was expended on the American citizen and bond buyer. First, he was sold the Allied Loan in 1915; then he was sold the war to safeguard our credits; then he was sold Liberty bonds to win the war; and since the war, he has been sold all sorts of foreign bonds to finance interest payments from the war debtors. The salesmanship has done its work at home. And it is the home folks who will do most of the paying for our war prosperity. Now that they are beginning to realize just how much they are going to have to pay, it seems timely to call their attention to a realistic account of how it all happened.

In 1914 the World War broke out of a clear sky. The statesmen had been receiving applause and peace prizes for keeping the peace, just as they always do until the next war. The war

wrought many interesting changes, among which was our transformation from international debtor by about 3 billion dollars in August, 1914, to an international creditor by about 14 billion at the end of 1919. Since 1919 compound interest has been mainly responsible for the growth of our net creditor position to some 21 billion dollars at present, counting government loans at 11.6 billion, the principal amount still payable, plus interest at different rates, under the funding agreements. American business men were responsible neither for the war nor for compound interest.

Two important explanations should be kept in mind about our post-war loans: first, they were not all made directly to war debtors; second, they were never made for the express purpose of paying interest. War loans were, as a rule, rather truthfully presented. The purpose of foreign loans will be discussed in a succeeding chapter.

At this point a brief explanation may be made of the statement that many of our post-war loans, which are really war interest loans, have not been made directly to our war debtors. An American loan to a South American republic served exactly the same purpose, so far as European debts to the United States on war account or any other account were concerned, as if the loan had been made to one of the war debtor countries. The dollar proceeds of the American loan were first credited to the South American borrower on the books of New York banks. The borrower then sold these book credits to local banks for local currency. The banks, in turn, resold these dollar credits in the forms of bills of exchange or telegraphic transfers on New York to persons having bills to pay abroad. Europe, being a creditor on investment balance with South America, thus received sterling or other foreign currency, by means of dollar New York credits sold by South Americans. In reality, England thus received dollars, instead of sterling, and with these dollars paid debts in New York which could not have been paid with British exports.

It should be noted that the South American countries have constantly exported more goods to the United States than they

have imported from this country. For the years 1922-1929 the yearly average value of our exports to South America was about 800 million dollars and of our imports from South America about 1 billion dollars. Our 5 billion dollars of investments placed in Latin America, of which nearly 2 billion have taken the form of loans to governments, have not, in consequence, paid for an American exports surplus of commodities in trade with Latin America. Our loans have simply given Latin America dollars to turn over to Europeans, which Europeans have used largely to pay interest on their debts—war and post-war debts—to us. Our loans to South America have really constituted transfers of dollar purchasing power on the books of New York banks to Europeans, via South America. The increase or decrease of dollar investments abroad raises or lowers a pool of dollars abroad. This pool is also fed by our imports and drained by our exports. From this pool, foreign debtors to the United States must extract dollars for the payment of debts owed to our citizens. For all practical purposes, as far as our economy is concerned, it makes little difference to whom or for what alleged purpose we lend money abroad. The funds go into the big pool in which they at once merge with all dollars abroad seeking purchasers among those who are importing American goods or who have debts to pay in America.

If the reader agrees as to the dynamic factors in our foreign trade, or the geneses of our foreign investments,—the factors being war and compound interest,—he will be ready to cope with certain figures now presented. The text will explain the salient facts shown in these tables, so it will not be necessary to an understanding of the thesis to study the tables. Such a study will, however, be most helpful and not difficult.

The first table shows our international investment position on three dates. On the first date, the end of July, 1914, we were a net debtor to the outside world by about 3 billion dollars, having 5.5 billion of foreign capital invested in this country and 2.5 billion of American capital invested abroad. On the second date, the end of December, 1919, or the close

of the war spending period, we were a net creditor of the world's by 14.1 billion dollars, having 3.8 billion of foreign capital invested here and 17.9 billion of American capital invested abroad. On the third date, the end of December, 1930, we were a net creditor of the world's by about 21 billion dollars, having 7.5 billion of foreign capital invested in the United States as against 28.5 billion of American capital placed abroad. This last figure includes the debts owed to our government stated at the principal amount owed as of November 15, 1930, of $11,640,000,000. Interest, of course, is additional, amounting to another 10 billion dollars over the 64-year period.

Table 2 shows how we got this way through the war. The story of this table, it is believed, will be intelligible without explanations to anyone who understands the rudiments of double entry bookkeeping. During the war period, July, 1914-December, 1919, we exported in goods 15,974 million dollars more than we imported. For these surplus exports we got paid mainly by the importation of 10,424 million in foreign government I.O.U.'s taken by our government, and 4,641 million in paper taken by American investors, plus 836 million in gold. There are some other items in the table, such as interest, services and unaccounted-for items. The total exports surplus, consisting of the items, goods, interest and unaccounted-for items, amounted in the 5½-year period to 18,232 million dollars. This amount was covered by an imports surplus in the following items: 15,065 million in paper (described above), 2,331 million in services, and 836 million in gold, making a total of 18,232 million.

It should be remembered that imports always equal exports just as in double entry bookkeeping books always balance, if properly kept, no matter how improperly the business may be run. The big balancing item in our war trade was our importation of 15,065 million dollars in paper assets, of which the United States Government took over two-thirds. The war gave the United States a chance to sell an exports surplus of goods amounting to 15,974 million, mostly for paper. The profiteers

TABLE 1. INTERNATIONAL INVESTMENT POSITIONS OF THE UNITED STATES ON THREE DATES

(Figures units of $1,000,000,000)	End of July, 1914	End of December, 1919	End of December, 1930
Investments of foreigners in the United States	$5.5[1]	$ 3.8[1]	$ 7.5[2]
American investments abroad	2.5[1]	17.9[1]	28.5[2]
Net position of the United States Debtor or Creditor	3. [1] Dr.	14.1[1] Cr.	21. [2] Cr.

[1] *International Financial Position of the United States, 1929*, Dr. Ralph A. Young, published by the National Industrial Conference Board.

[2] *The Balance of International Payments of the United States in 1930*, Department of Commerce, Trade Information Bulletin No. 761, pages 35, 40, 60.

New Estimate of American Investments Abroad, Paul D. Dickens, Trade Information Bulletin No. 767, 1931.

TABLE 2. HOW WE GOT THIS WAY DURING THE WAR

The international flow of goods, gold, services, interest payments and foreign and domestic assets into and out of the United States during the period July, 1914–December, 1919

Figures are units of $1,000,000

	Commodities and Silver	Services	Gold	Securities and Claims to Wealth	Government Loans and Repayments	Unaccounted-for Items	Interest	Total Exports or Imports
Exports	31,133	1,480	1,154	1,346	533	2,886	1,390	39,922
Imports	15,159	3,811	1,990	5,987	10,957	1,378	640	39,922
Balance	+15,974	−2,331	−836	−4,641	−10,424	+1,508	+750	±18,232

The pluses equal the minuses. Both equal $18,232,000,000. The pluses are the items in which there was an exports surplus. The minuses are the items in which there was an imports surplus. Imports always equal exports. Imports of foreign paper securities may pay for exports of American goods.

Source: *The International Financial Position of the United States*, by Dr. Ralph A. Young, (Page 36) and the *Studies on the Balance of Payments* of the Harvard Committee on Economic Research.

TABLE 3. HOW WE GOT THIS WAY SINCE THE WAR

Period Eleven Years, 1920–1930

SECTION A

GROUP 1. The Movement of Goods, Gold, and Services (exclusive of interest). *Realities.*

Commodity exports	$ 56,621,000,000		
Commodity imports	46,636,000,000	Commodity exports surplus (Sometimes called favorable balance of trade)................	$ 9,985,000,000
Service imports....	$ 15,543,000,000		
Service exports....	7,585,000,000	Service imports surplus (Might be called an unfavorable balance of trade)................	$ 8,171,000,000
Gold imports......	$3,802,000,000		
Gold exports......	2,461,000,000	Gold imports surplus....	$ 1,341,000,000
		Net exports surplus on above items..........	$473,000,000
Total Foreign Trade.........	$132,648,000,000	NOTE: Exports surplus...... $9,985 Combined imports surplus 9,512 Net balance... 473	

GROUP 2. The Movement of Capital. *Symbols.*

We bought from foreigners securities, property or claims to wealth amounting to...	$25,244,000,000
We sold to foreigners American investments amounting to..........	17,473,000,000
Our net import of foreign assets was, therefore................	7,771,000,000

GROUP 3. The Movement of Income on Capital. (Interest) *More Symbols.*

We received from foreigners on our investments abroad, including war debts..	$ 9,896,000,000
We paid to foreigners on their investments in the United States.....	2,632,000,000
Our net income on investment account was, therefore..........	7,264,000,000

NOTE: Our export of capital was $7,771,000,000. Our import of interest was $7,264,000,000, giving a net capital export balance of 507 million dollars to balance against our exports surplus of 473 million under Group 1. If Group 3 is merged with Group 1, our import of interest becomes a net export of services. This would increase our exports surplus under Group 1 from 473 million to 7,737 million which, practically, balances with our net import of foreign assets of 7,771 million. An import of foreign assets, symbols, corresponds to an exports surplus of realities. An exports surplus is called a capital export. Capital can only be exported on the items in Groups 1 and 3. Group 2 registers net movements in these groups. For every import there must be an export and vice versa. When the realities do not balance a movement in the symbols balances the difference on the imports or exports side.

TABLE 4. OUR WAR BOOTY, OR OUR FOREIGN ASSETS. OUR INVESTMENT POSITION ON TWO DATES

Sources: For Position as of December 31, 1919: *The International Financial Position of the United States*, Page 48. Ralph A. Young.
For Position as of December 31, 1930: United States Department of Commerce, Trade Information Bulletins Nos. 761, 767.

Our Investment Position as of December 31, 1919. The War did it.	
Private loans by Americans	$ 2,178,000,000
Direct investments abroad by Americans	3,500,000,000
Loans by the American Government (two-thirds of the booty)	10,246,000,000
Total funded assets	15,924,000,000
Still unfunded credits	2,000,000,000
Total foreign assets	17,924,000,000
Less investments by foreigners in the United States	3,800,000,000
Net creditor position of the United States	$14,124,000,000
Our Investment Position as of December 31, 1930. Compound Interest did it.	
American direct investments abroad	$7,840,000,000
American holdings of foreign securities, mostly bonds	7,204,000,000
Insurance company and bank capital	125,000,000
Total privately owned long term foreign investments	15,169,000,000
Short term loans to foreigners	1,725,000,000
Total privately owned long and short term investments	16,894,000,000
Debts owed to American government as of November 15, 1930	11,640,000,000
Total American holdings of foreign assets	$28,534,000,000
Foreign Owned Investments in the United States as of December 31, 1930.	
Long term investments	$ 4,700,000,000
Short term investments	2,793,000,000
Total foreign owned investments in the United States	$ 7,493,000,000
Our Net Investment Position as of December 31, 1930.	
After deducting foreign liabilities of $7,493,000,000	$21,041,000,000
After canceling war debts of $11,640,000,000	9,401,000,000
After canceling a conservatively estimated 4 billion dollars of defaulted bonds and overvalued investments at above figures	5,401,000,000

For a net creditor position, or net worth, on international balance, of between 5 and 6 billion dollars in a near future, in exchange for a net liability of 3 billion before the war, or a net gain since 1914 of roughly 8 or 9 billion, we exported 18,232 million more than we imported in the period July, 1914–December, 1919. Of this 18,243 million exports surplus, 15,974 million was an excess of commodity exports over imports. Does this not seem a rather costly price to have paid for the change in our real net worth on international account? Do these figures suggest that our war exports surplus have really enriched us? Then, of course, there is the small trifle of the costs of the war, not figured above. Does foreign trade pay? If we could consider our $28,534,000,000 of assets shown above as sound values, and if we disregarded the costs of the war, we might grant a case for the profitableness of our war trade. But these $28,534,000,000 represent very largely Dead Sea fruit.

got rich on this trade and the American taxpayer now holds the bag.

What has happened since 1919 is told in another set of tables, numbers 3 and 4. Compound interest is involved here. In order to make this financial history clear, it seems desirable to give certain brief explanations for a public not versed in the technique of international trade and finance. Foreign commerce may be conveniently thought of as a series of in and out movements, called imports and exports. The elements moving in these two directions may be divided into three groups: Group 1 comprises the real elements of trade. These elements are goods, gold, and services other than interest. Group 2 includes the symbols of wealth, such as bonds, stocks, titles to property of all sorts, bank deposit credits. This group may be called capital. When a country exports capital, the export takes place in the first group and the corresponding import takes place in the form of some symbol of ownership of, or claim to, foreign wealth. Group 3 includes items of income on capital invested abroad, such income taking the form of interest, dividends, profits and rents—mostly interest in international investments. Group 3 is likewise composed of symbols. The realities are all in Group 1, or goods, gold and services.

When the in and out movements of all the elements making up Group 1, or gold, goods and services, do not exactly balance, as this book maintains they always should do, there is an imports surplus into one country and an exports surplus from another country. Some people might call an imports surplus a deficit. The conventional ideas about surplus and deficit, however, are confusing if entertained in respect of these phenomena. To avoid this confusion, either an excess of imports over exports or an excess of exports over imports is called an imports surplus or an exports surplus. One should think, therefore, of a surplus either way as meaning only an excess of imports over exports or of exports over imports—nothing else.

A surplus or excess either way in the group of goods, gold and services must be accompanied by movements in the groups

of symbols called capital and income on capital. Thus, for instance, if a country has an exports surplus, it is either exporting capital or paying interest on capital it has imported or a combination of both. If a country has an imports surplus, it is either importing capital or receiving interest or principal on capital it has already exported, or a combination of both. Capital movements in the first instance are an expression in terms of property symbols of an imports surplus into one country and an exports surplus from another country.

With these explanations in mind, the reader will be prepared to grasp three sets of figures presented in Table 3 under sections A, B, and C, covering the eleven-year period 1920-1930 in American foreign trade history. The figures presented in tabular form in Table 3 aim to show how we got this way since the war. The first figure to observe, under Section A, is that of 473 million dollars, the amount of our total exports surplus over eleven years on the combined movements of the total volumes of gold, goods and services, exclusive of interest. This figure is most significant as it shows that our post-war loans and investments aggregating over 7 billion dollars could not really have financed any considerable exports surplus. In other words, our post-war trade has been on a barter basis, if one leaves out of account interest and capital. The realities have balanced since the war. Here are the figures over the eleven years: our exports surplus in goods, or what many people erroneously call our favorable balance of trade, was 9,985 million; our imports surplus on services was 8,171 million (American tourist expenditures abroad were a large part of this total); and our imports surplus on gold was 1,341 million. Hence, our net exports surplus was only 473 million dollars. This amount might, with some degree of fairness, be called our total favorable balance of trade over the eleven-year period.

Section B covering capital movements and Section C showing capital income movements may be considered as double-checks on the figures just given. These movements, perhaps, call for a few words of further explanation. Now, under the

heads of capital and capital income there are movements going on constantly in both directions. That is to say, while we were investing abroad, foreigners were investing in the United States and while we were receiving interest and dividends on capital invested abroad, foreigners were being paid by us interest and dividends on their capital invested in this country. All this is neither mysterious nor especially complicated, unless one wishes to make it so.

In order to know what has been going on, we have brought together in Section B all American investments abroad and all foreign investments in the United States during the eleven-year period. These figures include long and short term placements of capital; or purchases of bonds, stocks, real estate, mortgages, short term notes, deposits in banks, loans and, in fact, every class of capital investment. The results are: We invested abroad 25,244 million dollars and foreigners invested here 17,473 million; hence, we increased our net foreign investments by 7,771 million. Some would call this last figure our net export of capital. For all practical purposes it is. Needless to explain, these figures are only rough approximations. They cannot be complete or exact. They are, however, as nearly so as the research and published data of the Department of Commerce in its account keeping of the International Balance of Payments of the United States from 1922 and 1930 can make them.

The story of Section C covering capital income items is likewise brief. Our income on capital invested abroad, including payments to our government on war debts, was 9,896 million dollars and our outpayments to foreigners under this rubric were 2,632 million, showing a net income for the United States on capital items of 7,264 million for the eleven-year period.

Having stated these figures, we now bring together the threads of a fairly simple narrative. How did we take an interest income of 7,264 million dollars in eleven years, if, during that period our trade in the material elements of goods, services and gold balanced to 473 million? The answer is obvious: we took our net interest income of 7,264 million in

the form of 7,771 million of foreign paper assets we acquired, net. There was even enough left over from the proceeds of our purchase of this net increase in foreign paper assets to enable foreigners to purchase from us the exports surplus of 473 million dollars. International trade is really not a complicated business, if one seeks the truth and not selling arguments.

These figures have been worked out from the *Balance of International Payments of the United States*, covering the years 1922-1930 (United States Department of Commerce, Trade Information Bulletin No. 761), and for the years 1920-1921, from the appendix of the *International Financial Position of the United States*, by Dr. Young (National Industrial Conference Board), whose figures in turn are derived from the Harvard Committee on Economic Research. Obviously the presentation of these data has been simplified as much as possible and freed from many technical qualifications which would be required by professional economists. The conclusions reached and the figures proving them are believed to be valid, in all important or broad aspects. For the purposes of this discussion it seems unnecessary to attempt to explain items of a few millions in movements of billions. Importance attaches, not to precision in details, which must be impossible in such problems, but to approximate accuracy of conclusions as to the dynamic factors in the behavior of two simple movements—imports and exports.

For those interested in the composition of our foreign booty from war trade and compound interest, there is Table 4, giving an analysis of what we own abroad and what foreigners own here, as of two important dates, the end of 1919 and the end of 1930. The important facts in this connection, however, are not our foreign capital holdings or movements of capital and interest. The important facts are movements of the real elements of foreign trade: goods, services and gold. If these movements in and out of countries were kept in balance, as they should be, the world would be better off, but many bankers would have to start producing something for a living.

There would not be enough useful banking services required to keep the existing Wall Street banking organizations busy.

Juggling paper exports of capital with paper imports of interest is a little game, invented by the British, which has given to American bankers since 1919 a large slice of the national income and added absolutely nothing to the total volume of trade, production or welfare. The material elements of foreign trade, i.e., gold, goods and services, have, in their in and out movements since the war, balanced closely. This has been as it should be. The balancing of the movements of the symbols of our foreign wealth and income, however, has been the special feat of our New York bankers. Obviously the feat had to be performed if the American people were to enjoy the illusion of their ownership of great quantities of wealth in foreign lands. The bankers will doubtless argue that keeping up this illusion was a productive service on their part.

Yet the evidence of history shows that the larger the traffic in symbols of foreign wealth and income carried on in Wall Street, the easier it is for men there to make money by doing nothing but juggling these symbols. The mischief of it all is not the profits the bankers make by such juggling, but the disturbance they cause in world economy.

The outstanding conclusion of this chapter as to the post-war growth of our foreign investments solely by the play of compound interest is expressed by Dr. Ralph A. Young in the following paragraph of his thesis, *The International Financial Position of the United States, 1929*: "Contrary to opinion, the nation as an economic unit has not been placing larger and larger amounts of its available liquid capital supplies abroad, but has been mainly accumulating foreign securities by reinvesting interest, dividends and capital repayment sums received each year. . . . Taken as a unit, the country has been largely reinvesting income and capital repayments from former investments."

Our war-gotten booty, or foreign investments, really constitutes an endowment or estate in perpetuity created by the American people in favor of our international bankers. It is a

perpetual, legalized and recently glorified racket for them. Wall Street got us to acquire a 14-billion-dollar war booty (the net creditor position as of December 31, 1919), first, by profiteering as neutrals, and then, by entering the war and lending our allies more money for the ends of destruction. Thereafter, the bankers have had a permanent racket in the business created by refunding the interest payments on the incubus of war debt so laid upon mankind. Obviously the debtors cannot pay in gold and it would paralyze our industry to take payment in goods or services. Hence, the bankers annually save the country from the paralyzation of its trade by juggling the symbols of wealth and income which have grown out of our war profiteering.

Periodically, there must occur unpleasant periods of debt cancellation, called by the bankers "scaling down." The debts then grow up again like a cancer which has been partly cut away. Then again, when the yearly compounding loans become too large for the investment and money markets, the effects of the sheer play of compound interest are once more partly undone. And so on, far into the years; that is, provided capitalism can survive the indefinite exploitation of the English bankers' classical racket on the scale it has attained at the hands of American war profiteers.

CHAPTER XX

CAMOUFLAGED INFLATION

THIS chapter shows how foreign trade is used as a means of camouflaging inflation. It also shows that the charm works only as long as new loans exceed interest payments. The deception begins by creating the illusion that the extension of credit is "productive." All that is needed to prove a loan productive is an economist and an adding machine. The joker about productivity, which will be explained in a chapter devoted to the question of the productivity of foreign loans, is that as production increases, prices fall. In consequence, the borrower's capacity to pay debts declines faster than his production increases. Thus, taking the figures for 1925 as the base of 100, we find that in 1929 for the total volume of world trade, prices were 88, physical quantity, 120; and the total value 105.[1] The story for the borrowing countries is much worse than these figures indicate, because the decline in the prices of the raw material exports of the debtors was much greater than that of the general world average indicated by the above indices. The point is that economists and machines in the service of bankers do not think. They work efficiently and produce extremely accurate results when whoever is operating them pulls their lever.

The idea that it may be impossible ever to transfer any considerable part of debt payments, even of interest, because production cannot be sold at a remunerative price in the money of debt payment, has been scoffed at by New York bankers, Department of Commerce officials at Washington and subsidized American economists. The transfer problem was non-

[1] *The Course and Phases of the World Economic Depression*, Secretariat League of Nations, 1931, page 125.

existent just as long as new investors could be found to lend the borrowers the interest payments.

Foreign investments lend themselves to all sorts of other mystifications. A railroad, for instance, would not, nowadays, be permitted by the Interstate Commerce Commission to increase every year its bonded debt, assuming suckers could be found to buy the bonds, for the admitted purpose of making new constructions merely to keep the operating plant intact. Railroads are supposed to keep their plant intact without increasing debt. A foreign government, however, can increase its debt continuously for alleged new public works which are merely replacements or constructions to keep its operating plant intact, and the government can have American bankers represent to their clients that such uses of the borrowed money are "productive" capital expenditures. There is no government, rational or other control of loans to foreign borrowers.

Government and corporate uses of borrowed money also increased in attractiveness to investors by the square of the distance. A proposal for a bond issue to mature after thirty or forty years for the expressed purpose of financing the sale of 100 million dollars' worth of merchandise in the state of Kansas would not be taken seriously. If the purpose were called public works, such as municipal theaters, bathhouses, irrigation works or social expenditures, the loan would probably be denounced as a measure of public extravagance. The same loan to a mestizo republic in the tropics—for productive public works—would be recommended again and again by the most reputable New York bankers and sold to small investors as a sound, conservative and "productive" investment. It is inflation in Kansas. In Australia, Peru or Germany it is "productive."

Thus we see that foreign trade enables New York bankers to exploit Mr. Ponzi's idea of paying dividends out of fresh capital subscriptions, and to finance "socialistic" projects in foreign countries. We shall now look at the mechanics of this foreign trade-inflation racket.

Selling abroad on credit is done by means of long term

investments which have no direct connection with sales of goods to foreigners. Commercial credits are extended to foreign merchants by banks, usually in the form of commercial letters of credit or an agreement to accept drafts. The term of such extensions of credit is from three months to a year, usually no longer. The security is the goods in transit or in stock, and, in addition, the personal guarantee of the exporter and the importer, as well as that of another bank, in many cases. As old commercial credits are being paid off by sales of the goods as fast as new credits are being opened, this type of financing is only a method of slightly deferred payment. Such credits, obviously, do not finance an exports surplus, or sales on credit, from the point of view of the exporting nation, unless the total volume of such credits expands in one year.

The essence of foreign trade inflation is the maintenance of an exports surplus. This is achieved by investing each year a larger amount abroad than the previous year, or sufficient to cover all interest charges and pay for a quantity of exports. Starting out with a yearly income of, say, one billion dollars, about the amount foreigners should be paying us each year, at present, we should have to add on an additional amount to pay for (1) the desired exports surplus, and (2) accumulating interest charges. The yearly amount would grow in geometrical progression, the yearly term of progression being determined by the interest rate of 7 per cent. In about ten years we should have to be lending two billion dollars a year, and so on, *ad infinitum.*

Cancellation of foreign debts is a mathematical necessity, once they cannot be paid promptly. The larger the amounts and the higher the interest rates, the sooner the necessity for cancellation becomes imperative. Compound interest is ruthless. So much for the theory. Let us look rapidly at a few historical examples of foreign borrowing to see whether foreign loans have ever served any country for any length of time as a source of enrichment or development.

The first case to be considered will be that of the United States during the 93-year period from 1821 to 1914. The figures

given are based on a compendious study entitled *The Balance of Trade of the United States 1789-1914*, by Messrs C. J. Bullock, J. H. Williams and R. S. Tucker, published by the *Harvard Review of Economic Statistics*, July, 1919.

The United States	Period 1821–1914		Units of $1,000,000
We received in capital from investments by foreigners......	$4,165	We invested abroad...........	$1,000
We received in interest on our foreign investments.........	760	We paid foreigners in interest or dividends..................	6,778
We got..................	$4,825	We paid.................	$7,778

The argument that imports of capital were an important factor in our early development is conclusively refuted by these figures. During the periods 1821-1837 and 1850-1873 we were on the receiving end by a small margin. The rest of 93-year period we were sending abroad far more than we were receiving from abroad. We were a good field for the investment of foreign capital precisely because we borrowed little. We are to no appreciable extent indebted to what we borrowed for our prosperity or growth. Dr. Ralph A. Young, in his work, *The International Financial Position of the United States, 1929*, page 29, 30, states the facts as to our debt to foreign investments, when he says: "It can hardly be said, however, that the United States as a whole was ever heavily mortgaged. At the most, not more than 5 per cent of the money value of the nation's economic wealth was ever represented by securities or other property held abroad and for most of the period surveyed, the percentage was probably less than 3 to 4 per cent. Interest payments could hardly have been more than 1 per cent of the aggregate money income of the American people in the period 1870-1880 and in other years they were slightly less."

It should also be added that in those days there was nearly always a strong demand at a remunerative price for more American exports than could be produced and shipped. That condition does not hold today for the products of South America, Australia or Germany.

One may hazard the guess that had other new countries of South America and Australia been developed less with absentee owned capital, their present situation would be more happy. If Chile today had, like the United States in its poorest days, not more than 5 per cent of its national wealth mortgaged to foreigners, instead of over a half, it would probably have no communist problem. It must, of course, be understood that the American nation owes almost everything to foreign immigration and the capital in brain, brawn and character, together with liquid funds, brought to this country by foreign settlers. But these additions of capital ceased to be foreign the moment they touched our shores. Migrations of capital create no problem. It is the absentee capitalist who is the menace to economic stability and welfare. The capitalist who goes abroad with his capital and equipment to throw in his lot with that of another people is a gain to the country to which he goes and a loss to the place whence he departs. The capitalist who sends wealth from the place where it was produced to another country in search of higher profits is good for neither country nowadays.

The figures of capital imports for Canada during an important period in which it was a heavy importer of capital may be taken from an excellent study on *Canada's Balance of International Indebtedness*, by Professor Jacob Viner. The essential facts are the following:

CANADA. Period 1900–1913

Figures are in units of $1,000,000

Canada imported in foreign capital	2,546	Canada paid in interest and dividends to foreigners	960
Net Canadian imports of capital during the period			1,586

This is a clear example of a country during a short period importing capital in real earnest. Canada would, undoubtedly, have had a complete collapse shortly after 1913 had it not been for the World War. This happy event for Canada gave her a market for her wheat at inflated prices. There was the further happy circumstance for Canada that a large part of

the foreign capital she had imported had been quickly and irretrievably lost by the hapless foreign investors in land booms. One of the great evils of American foreign investments since the war is the fact that they have consisted over half in public loans. It is naturally a more serious business for a borrowing country to have its government go bankrupt than to have its land or industries swallow up without a trace a lot of foreign capital. Canada had the luck of the war to retrieve largely the error of its borrowing spree. A good-sized world war in 1929 would have averted the bankruptcies of the South American governments now in default.

The history of Australian imports of capital has been brought up to 1931 by Mr. Roland Wilson in a study published in the Economic Record, of May, 1931, and entitled Australian Capital Imports. The important facts may be presented as follows:

AUSTRALIA. Period 1871–1930

Capital imports 3,830 million dollars in entire history

Figures are units of $1,000,000

	Period 1904–1913		
Capital imports: Minus	65	Interest paid	761
	Period 1914–1919		
Capital imports	656	Interest paid	650
	Period 1904–1930		
Capital imports	2,060	Interest paid	2,945
	Period 1919–1930		
Capital imports	1,400	Interest paid	1,534

No figures could be more informative about the phenomena of borrowing over a long period by a heavy borrower. From 1904 to 1913 Australia was paying interest on capital imported up to 1904 and reducing slightly the principal amount owed abroad. This was a sound period. Australia was not importing capital. From 1914-1919 Australia was borrowing somewhat in excess of her interest payments. During the post-war period, although Australia has been a heavier borrower, she has not really been importing capital, but merely borrowing about 90 per cent of her foreign debt charges. Australia is now virtually

bankrupt because the foreign bankers cannot sell enough Australian bonds each year to provide the foreign exchange to pay Australia's debt charges. Foreign borrowing has not contributed one cent of capital to Australia over the period 1904-1930, but taken out of Australia 900 million dollars more than it has given to Australia.

The story of German imports of capital since Germany was economically rehabilitated by the Dawes Plan will be the concluding example. The figures are based on those of the Financial Committee appointed on the recommendation of the London Conference of 1931. The Committee was headed by Mr. Wiggin, chairman of the Chase Bank of New York. During the period 1924-1930 Germany increased her foreign indebtedness by about 6.4 billion dollars, but this was offset by the acquisition of foreign assets worth over 1.8 billion, so the net increase in German indebtedness is estimated at about 4.5 billion. During this period, according to the figures of the German Statistical Office, Germany has paid to foreigners in interest about 625 million dollars and in reparations about 2.5 billion. Total outpayments for interest and reparations have, therefore, been about 3,185 million. Deducting this last figure from net capital imports of 4,540 million, we have 1,355 million dollars of foreign capital which came into Germany and there remained to support inflation in Germany, or to be "productively" employed. Unlike Australia during the post-war period, Germany has actually imported capital from abroad in excess of her interest payments to foreigners.

The examples cited of borrowing countries, the United States, Canada, Australia and Germany, all make it clear that the term "capital imports" is misleading when accompanied by no explanation of what has taken place. The important fact is that foreign loans give a country additional capital, or purchasing power abroad for spending purposes, as distinguished from interest paying, only during a relatively short initial period. After this short period has been terminated by interest overtaking the amount of possible new loans, the country must stop importing capital and start paying interest by a combina-

tion of increased production and reduced consumption, or march inevitably to default.

Returning to the central thesis, it may be said that many people who champion more foreign trade are unaware that what they really want is more foreign loans to finance additional sales to foreigners; and they are equally ignorant of the fact that loans can finance such sales only to the extent that money loaned exceeds interest received. In other words, few people realize that foreign loans are open to the same objections as installment credit, already discussed.

It may be objected by many sincere but unthinking people that a plea for more foreign trade is motivated simply by a desire for a wider international exchange of goods and services. Conceivably this might be true. Practically, it never is the case. The reasons are obvious to those who understand the facts. Every plea for foreign trade is expressly justified by the argument that it will increase production, improve trade and relieve unemployment. No one would be so absurd today as to suggest that he thought the United States was suffering from insufficient supplies of rubber, coffee, tin, copper or manufactured goods from any part of the world. Our markets were never more glutted with goods. The term "tariff wall" is grossly misleading and wholly unwarranted by the facts. The people who, in cartoons, are languishing behind tariff walls are languishing not because high tariffs makes prices high and foreign supplies scarce or dear, but because they cannot find work. The idea that, if we had no tariff and could buy foreign goods more cheaply, we would at the same time buy domestic goods for which we have not enough purchasing power at present is pathological rather than rational.

The people who argue for more foreign trade and who are not pathological cases on the subject of free trade know quite definitely what they want. They want to sell goods abroad on credit that they cannot sell at home on credit. Mr. Hearst, for instance, made a plea through his papers for a 3-billion-dollar prosperity loan, which no one took seriously. But the sale of billions of dollars of foreign investments in our market in one

year has been a reality. The man who advocates more foreign trade usually understands these facts.

A theoretical demonstration will now be made of the fact that foreign trade can only increase production to the extent that foreign trade is used as a vehicle of inflation. The fact that people will accept inflation in this form who will not accept it in the usual domestic forms has already been shown. Let us suppose that a country is producing 100 units of production and exchanging 10 units for 10 foreign units, a supposition which almost exactly fits the facts of the foreign trade of the United States during the past five years. Our exports have averaged about 10 per cent of our production of movable goods, though only about 5 to 6 per cent of our total national income.

Now suppose three separate tariff policies, attended by three distinct sets of effects on the total volume of foreign trade, but let us assume with each supposed tariff policy the same amount of capital exports or foreign loans. Under supposition No. 1 the tariff remains unchanged. Foreign imports remain unchanged. One hundred ten units are produced. Ten of these units are exchanged for foreign I.O.U.'s and 10 units for foreign production. Under supposition No. 2 the tariff is raised. Foreign imports are reduced by one half. One hundred ten units are produced, 10 of which are exchanged for foreign I.O.U.'s and 5 of which are exchanged for 5 units of foreign goods or services. Under supposition No. 3, the tariff is lowered. Foreign imports are doubled. One hundred ten units are produced, 10 of which are exchanged for foreign I.O.U.'s and 20 units for 20 foreign units.

The same set of suppositions, with capital exports left out, will show total production always at 100. Under a tariff reduction certain domestic producers will be producing more, others less and some not at all. It is optimistic in these supposed cases to assume that the disturbances caused by tariff changes would not reduce production and result in some importation on credit or diminished consumption. At best, total production would remain unchanged in quantity, or always 100. The point

is that an increased volume of foreign trade does not mean an increased volume of production, where foreign imports are paid for with exports of domestic goods. It makes absolutely no difference to the American producer who consumes his product or how the consumer gets the money to pay for it. The producer's prosperity and the worker's job depend on the effective total demand. Total demand can be increased only by increasing purchasing power among those willing to spend. The free trade champions of more foreign trade can never grasp the simple fact that $1,000 of domestic goods exchanged for $1,000 of foreign goods creates no more purchasing power or consumption than selling $1,000 of domestic goods for $1,000 of domestic goods.

It is selling 10 units on credit, whether at home or abroad, that increases, in the supposed cases, total production to 110. The important fact about exports on credit is that they can be made equally well with free trade or a high tariff, as their vital principle is increased volume of purchasing power. Nothing else but the increased volume of purchasing power matters. Tariff has literally nothing whatever to do with the generation of prosperity by the use of credit or inflation. The theoretical proof has been developed. The concrete examples are furnished by the pre-war history of foreign trade prosperity, which was financed and conducted in the same way by high tariff Germany and free trade England. These two countries are now industrially crippled because they cannot sell abroad on credit, not because one has been a high tariff and the other a free trade nation.

Tariffs are no obstacle to inflationist prosperity through foreign trade. There is one and only one obstacle and that is the unwillingness or incapacity of lenders to lend more. Where there's a loan there's a way, tariff or no tariff.

In closing, the example of Russia will be cited. The real grievance of the industrial nations against the Bolshevists in Russia is that communism has closed Russia as a field for inflation by foreign capital. Communism has eliminated Russia from the list of the countries that formerly imported vast quan-

tities of goods on credit, about 3 billion dollars having been lent to Russia by France alone by 1914. By the repudiation of the Czarist debts and the seizure of foreign capital in Russia, the communists have prevented the gift to Russia of enormous quantities of goods in return for nothing but I.O.U.'s. This grievance has been aggravated by the attempts of the communists to pay for foreign goods with Russian products, notably wheat and manganese. The enormity of the Russian offense was heightened by the fact that our Farm Board had been trying unsuccessfully to sell to the Italian Government some 60 million bushels of wheat for two-thirds of the price paid by the Stabilization Corporation for the wheat. Even so, the evil communists got the business by underbidding our government agents in the wheat business. If Russia had only had a sound government which respected the obligations of its imperial predecessor, it would have been so easy for our bankers to put a stop to the evil of Russia's paying cash for its purchases in foreign markets.

Could Moscow but have made a few graceful gestures several years ago, her government would have been recognized, the Czarist debts would have been cheerfully canceled down to a fraction of their former amount and the old game of lending Russia millions every year could have been resumed by France and Great Britain and joined in by ourselves to the delight of all the lenders. The tragedy of debt repudiation is not that it prevents repayment. The economic masters of the lending countries will never allow repayment anyway, if they can possibly help it. The disastrous thing about debt repudiation is that it stops future lending to the repudiator. The new lendings to Russia would naturally have covered several times as much as the yearly service charges on the new consolidated Russian foreign debt. The Russian communist officials could have been rapidly corrupted as were their imperial predecessors.

It may be a little beside the point, nevertheless it is opportune in this connection to remark that a great opportunity was lost by American capitalism to assure the speedy downfall of Russian communism in its early stages. Our prompt recogni-

tion, friendly cooperation and several large loans for "productive purposes" could have done for the communist dictators what they did for every single dictator in South America who borrowed in New York during the late new era. The only president in South America who has been in power for a quarter of a century is General Gomez of Venezuela, who has never borrowed a penny abroad and who at the height of the present depression in 1930 paid off the last cent of a small remainder of an old foreign debt. His government has for a long time past had a large cash surplus on hand. It, therefore, laughs at popular discontent, which is understood not to be inexistent in that republic. In one South American republic our bankers paid the son of the president in less than two years over half a million dollars in commissions on loans publicly offered in New York. That president and his son have been kept in prison since his overthrow, having been found by a tribunal to have misappropriated some 7 million dollars of public funds while in office.

It may be a full generation before Russian communists realize how much they owe to Mr. Hughes for saving communism in its infancy from the burdens of an impossible foreign debt, from graft with the proceeds of foreign loans, from large scale American financial cooperation and from abject dependence on the export trade. He forced Russia to perfect a permanent substitute for foreign trade inflation.

CHAPTER XXI

ARE FOREIGN LOANS NECESSARY FOR PROSPERITY?

FOREIGN loans are subject to attack on the specific ground that they are the wrong road to prosperity. Jointly with the development of this negative thesis, in this and the next chapter, a case will be advanced that adequate domestic expenditures out of taxation constitute the right road to prosperity. Let us begin by setting up authoritative statements of the foreign loan road to prosperity made by three of its eminent defenders: Sir George Paish, British economist, Mr. Reginald McKenna, Chairman of one of England's largest banks and a former Chancellor of the Exchequer, and our own Mr. Hoover, who, naturally, shares their views.

In his book, entitled, *The Road to Prosperity* (1927) (Page 18), Sir George Paish wrote, "They [the British people] discovered that they could not sell their goods abroad without giving credit and they consequently created a system which enabled them to pay cash for what they bought and to grant credit facilities for what they sold."

Addressing the American Bankers Association on October 5, 1922, Mr. McKenna said: "For over two centuries English capital has been lent to other countries. Year by year England has produced more than she either consumed herself or could exchange for the products of other nations and she could not obtain a market for the surplus unless she gave the purchasers a long credit. Foreign loans and foreign issues were taken up in England and the proceeds were spent in paying for the surplus production. British factories and workshops were kept in good employment, but it was a condition of our prosperity that a part of their output should be disposed of in this way."

And our own Mr. Hoover, outlining for a committee of the American Bankers Association on December 10, 1920, his idea

of the American road to prosperity, said: "I believe that we have today an equipment and a skill in production that yield us a surplus of commodities for export beyond any compensation we can usefully take by way of imported commodities. For me there is only one remedy and that is by the systematic permanent investment of our surplus production in reproductive works abroad. We thus reduce the return we must receive to a return of interest and profit."

Mr. Hoover's belief that the American people cannot consume all they can produce is an obvious heritage of eighteenth century mercantilism. The earlier mercantilists wanted all the time to export goods for gold. Mr. Hoover preferred foreign paper on which the nation would receive what Mr. Hoover called "a return of interest and profit," in more foreign paper. After twelve years of the zealous practice of his system, we have accumulated 28 billion dollars of foreign paper, as shown in Chapter XX. At the same time, we have six to eight millions of unemployed for whom Mr. Hoover's only solution in 1931 was begging.

It should be explained that a nation is consuming all it produces, regardless of the size of its foreign trade, when it consumes a full equivalent of foreign goods for the domestic goods it exports. Such a healthy type of foreign trade is, of course, not what Mr. Hoover advocates. His system consists of exporting American goods for foreign paper, the assumption being that the American people cannot consume their total output in domestic goods, or their equivalent in foreign goods. This book, let it be carefully noted, does not oppose foreign trade. It opposes Mr. Hoover's "systematic permanent" exchange of American goods for foreign paper.

To talk of surplus production in any country is utter nonsense. Assuming people are free only to work as much as they like, there can be no such thing as too much production. Human wants are nearly insatiable. There has been no indication in recent years that Americans were becoming satiated with overconsumption. Absolute overproduction could only mean that people were slaves forced to work to produce more goods,

when they would really prefer to have fewer goods and more leisure.

What Mr. Hoover meant by "surplus production" was that many merchants could not sell as much of certain highly profitable commodities as they desired. The mercantilistic solution was for American investors to lend money to the Republic of Amazonia or the Kingdom of Belgravia for public works in order that foreigners might have more dollars with which to buy more American automobiles. The rational solution is, obviously, to make fewer automobiles and make more of other things that Americans want and would pay for, if given the chance to earn the money.

That foreign loans stimulate domestic production while they exceed interest payments due from foreigners goes without saying. But it is equally true that domestic inflation produces the same result, with this advantage, that the producers keep the goods for use, as well as have the fun of making them. This book, as has already been indicated, opposes both inflationary solutions and favors direct levies on capital for domestic spending. The essence of the whole problem, however, is the creation of more demand, or, quite simply, spending more.

The Report of the MacMillan Committee goes right to the heart of this matter when it says: "If a creditor country is disinclined to lend its savings to a debtor country, then let it employ these savings at home. It is only to do *neither*, but to accumulate, or endeavor to accumulate, the surplus savings in gold which serves to embarrass the debtor countries as a whole. We repeat that it is the simultaneous reluctance of creditors *either* to lend *or* to buy which is the cause of the crisis." (The italics are those of the Committee.)

The fundamental idea expressed is eminently sound, but the recommendation of more foreign loans ignores the obvious fact that too many foreign loans are the fundamental cause of the whole trouble. We need more spending. That is evident. But we do not need to lend foreigners the goods, or money, to do the spending for us. We have some good spenders in America. All they need is a chance. The suggestion that there

is not a field in any country for the investment of its full savings is an insult to anyone's intelligence. To say that it is more likely that savings will be unwisely invested at home than by foreigners is an even greater insult to one's intelligence. These somewhat sweeping statements will be proved with facts and figures in the chapters to follow.

At this point it is appropriate to analyze Mr. Hoover's economic ideas which are the basis of the belief held by the school to which he belongs that rich Americans should save and invest a large surplus abroad, instead of spending or investing all of their income at home. Mr. Hoover's philosophy in this respect is suggested in the following brief extracts from his Indianapolis address of June 15, 1931:

"For instance, nothing can be gained in recovery of employment by detouring capital away from industry and commerce into the treasury of the United States, either by taxes or loans, on the assumption that the Government can create more employment by the use of these funds than can industry and commerce.

"Not only must we refrain from robbing industry and commerce of its capital and thereby increasing unemployment but such works require long engineering and legal interludes before they produce actual employment. Above all, schemes of public works which have no reproductive value would result in sheer waste. The remedy to economic depression is not waste, but the creation and distribution of wealth."

It would be difficult to compress more fallacies into as few words. Yet every one of them is sacred among American business men and, hence, among the people. First, Mr. Hoover erroneously assumes that government expenditures reduce industrial and commercial investments. Second, he erroneously assumes that government expenditures are more likely to prove wasteful or unproductive, whatever these terms may mean, than business uses of money, such as growing Brazilian coffee to be burned or erecting office buildings, apartment houses and factories to stand idle. Third, he assumes, for no reason at all, that the cause of the depression is a want of wealth and that

the cure is a creation of wealth, instead of waste. Obviously, the cause of the depression is maldistribution of wealth, due largely to the policies of easing the tax burdens of the rich extolled by Mr. Hoover. The main symptom of the depression is insufficient waste. The cure of the depression must be a progressive redistribution of wealth and income, and the first symptom of the cure will be a sharp increase in waste. All this is so simple and obvious that it seems trite to say it. But beliefs cherished by business men and solemnly proclaimed by their spokesman in the White House demand somewhat serious refutation, which will now be attempted.

Mr. Hoover assumes that the money which the government might desist from spending will find a more beneficial or, as he would say, a more "productive" use by business men. The plain fact here is that the banks cannot during a long depression find eligible users for their idle funds or credit. Moreover, all government expenditures constitute diversions of purchasing power from taxpayers into the channels of trade. The government does not spirit money away into nothingness. A million dollars spent on munitions for target practice causes exactly as much business activity as the same amount spent blasting foundations for unrentable New York office buildings, or on bread or moving pictures. The people can get on without moving pictures quite as well as they can dispense with navy target practice.

Mr. Hoover is thinking in terms of no reality at all when he supposes that American industry and trade are in need of capital for productive plant or uses. What industry and trade most need at present is increased waste which would give demand for more goods. The idea that every dollar saved for rich taxpayers means another dollar spent by the rich on producer's goods is not true. Mr. Hoover, along with other business men, naturally reasons that every dollar saved for the rich means another dollar either spent on consumption goods or invested much more wisely than the government could invest money. Let us now proceed to the demonstration of the utter fallacy of this assumption.

The point overlooked is that bank deposits, other than those of savings banks which are insignificant in relation with the total, arise mainly from loans, say, 70 to 80 per cent of all deposits grow out of loans. A merchant or manufacturer borrows $1,000 from the bank, which at once increases its deposits by $1,000 and its loans by the same amount. As the amount is spent, the money becomes deposits in other banks. In thus creating bank money, of which we have approximately 50 billion dollars, or one-sixth of our total wealth, against promises to pay, banks are limited only by the requirement to carry in cash or Reserve Bank deposit credit about $7 for every $100 of deposits.

Now, if commodity prices are falling, business profits declining, security values sinking, most of the best bonds going into default, what does the intelligent investor do, who has sense enough not to listen to Washington and Wall Street? Obviously, he tries to lose as little as possible. He, therefore, hoards money. Banks and investors who have not hoarded since 1929 have, as of December, 1931, taken a bad beating, equal to about one-third of their capital, on the best bonds of domestic vintage and over 15 per cent on many issues of United States government bonds. These are facts, not propaganda. They may be checked by anyone against any representative list of bonds. The wise banker in a nation of dying businesses tries to be the last to die. About 10 per cent of the banks, however, have expired during the past two years. There is nothing bankers can do to relieve the depression. All that a conscientious banker can do is to try to keep alive as long as possible.

With these brief statements of fact clearly in mind, we are prepared to answer the question, What do banks do with deposits received from savings during a depression? The answer is that banks invest such savings in government bonds or nearly riskless financial paper paying around 2 per cent, which is the equivalent of hoarding. The point is that loans decline in measure as such savings are received on deposit by banks. The commercial bank receiving the deposit of savings merely substitutes this money for deposit money growing out of loans to

business men. In this way it happens that a billion dollar increase in total savings going into commercial banks will coincide with a greater decrease in commercial loans, and with some decline in total deposits. The banks just take up commercial loans, reduce their total deposits somewhat thereby and buy more government bonds or 2 per cent financial paper. The following table of figures taken from the compilation of the Federal Reserve System of all banks in the United States will show how the processes just described have registered their trends over the past five years. Loans went up from 1927 to 1929 and came down from 1929 to 1931. Investments, mostly government bonds and financial paper, have gone up as loans have gone down.

Last Banking Day of June	Loans	Investments	Total Assets	Deposits
	Figures are in units of $1,000,000			
1927	37,360	16,391	53,750	51,662
1928	39,464	17,801	57,265	53,398
1929	41,512	16,962	58,474	53,852
1930	40,618	17,490	58,108	54,954
1931	35,384	19,637	55,021	51,782

A close reasoner may exclaim, "Ah, but if savings, piled up by Mr. Hoover's economy policies, go on accumulating in the banks, the banks and investors cannot go on forever buying government bonds and financial paper, while at the same time reducing commercial loans and new investments." This remark has little point. Obviously, credit contraction cannot reduce commercial loans to zero, but it is only necessary to have a yearly contraction of commercial credit for several years, to be followed by stabilization at a lower level, to insure grim economic tragedy for the entire country and a general reduction of the standard of living.

Let us develop the refutation along a slightly different line: Let us take corporate dividends, for an instance. They were 350 million dollars greater in 1930 than in 1929, and 1,500 million in excess of those paid in 1928. Did investors invest more in 1930 than in 1929? Let the following figures of new capital issues in the United States answer the question:

CORPORATE, FOREIGN GOVERNMENT, FARM LOAN AND MUNICIPAL FINANCING. NEW CAPITAL

Units of $1,000,000

1926	1927	1928	1929	1930	1931
6,344	7,791	8,114	10,182	7,023	3,108

Why did investors invest less in 1930 than in 1929? The answer is that there was less of what President Hoover and business men seek to reduce, namely, waste. Wages were 8,653 million dollars less in 1930 than in 1929. In this way a great deal of waste was avoided. Machines, for instance, are saving money that was being wasted on wages. Wage reductions are further reducing waste. Plainer living is also cutting down waste. The railroads are going into bankruptcy mainly because people are wasting less money on unnecessary transportation. And the enumeration might be continued indefinitely.

Now, the whole point of this somewhat hurried demonstration of an obvious present-day reality is that Mr. Hoover's assumption that savings must be promptly reinvested is an utter fallacy. Mr. Hoover cannot furnish a scintilla of statistical evidence during the period August, 1929-December, 1931 to support his assumption. It is a piece of wishful thinking. The truth is that during a boom investors invest, through the use of credit, considerably more than their savings, while during a depression they invest considerably less. Certainly those who have common sense invest less than their savings during a period of falling prices. The way to make investors invest their full savings is to stop the fall of prices. And the way to stop the fall of prices is to waste more, not try to deceive the people with false optimism. Eventually even investors grow wise.

A part of Mr. Hoover's non-waste, economy program is, of course, large foreign loans. The motto is "Save and invest." But a large foreign field, promising fictitious, high yields, is needed to support the slogan.

Mr. Hoover's advocacy of disarmament as an economic restorative rests on the same fallacy. It will be shown in the remainder of this chapter how foreign loans and disarmament

are closely connected. Mr. Hoover tells Europe that the remedy for economic distress is to cancel orders for armaments and send thousands of men from the army of the nation's defenders into the army of the nation's unemployed beggars, now over 20,000,000 in the industrial countries. The assumptions are simple. Were European military budgets curtailed, taxpayers would have more to invest. This assumption is correct. The assumption that investors would invest money so saved is a pure *non sequitur*. Of course, Mr. Hoover is concerned more over the saving which a general reduction of armaments would allow the American Government to realize for taxpayers than he is preoccupied over the effects on the depression in Europe.

But what reason can Mr. Hoover have for supposing that capitalists would spend or invest more if their taxes were lowered? For the past four years money rates in France have been the lowest in the world. France gained a half a billion dollars in gold in one year, or from $1,668 millions on March 1930 to $2,326 millions in September 1931. This increase in gold in the vaults of the Bank of France coincided with the first marked decline in production and symptoms of unemployment in France since 1920. Yet Mr. Hoover would save money for the French taxpayer by discharging soldiers from the French army.

The obvious fact is that French investors and banks have had far more money and credit than they have known what to do with, especially now that they can no longer throw away millions every year in Russian loans. It goes without saying, that if the money spent on the army were spent on social services, the results for employment and prosperity would be about the same. But Mr. Hoover, in his campaign for reduction of public expenditures on armaments, has never advocated a corresponding increase in other government expenditures. On the contrary, he proclaims the virtue of government economy all around. When men are looking for work by the millions in his own country, he closes enlistment in the Marine Corps and orders retrenchment on government employment.

There are excellent reasons for total disarmament and world

peace. It is permissible to hold that money is better spent on Hollywood than on the United States Navy. It is proper to regard empty factories which serve no useful purpose as preferable to battleships which house and employ thousands of men. It is no doubt reasonable to assume that the United States which has had a big war on an average every thirty years in its history, not counting minor wars with the Indians, Cubans, Haitians, Santo Dominicans, Nicaraguans and Filipinos, has had its last war and will have no further need for a military establishment except for ceremonial uses. But where is the economic logic of sending men from the army into the bread line? In the bread line they will, undoubtedly, eat less, wear less and spend less. The nation will thus economize on their keep. Mr. Hoover will realize his ideal of reducing government expenditures. But, how will this help business?

On the humanitarian side, a realist fails to see the humanity of turning a fellow man out of a home, a job and a living in the service of his country, even though such service be wrong, to walk the streets in search of a job and a soup kitchen. When Mr. Hoover has found work for America's unemployed, he will have an answer to the arguments of this critique of the economics of disarmament. It may be said that it is not Mr. Hoover's function to create work for the unemployed. This book then replies: It is not Mr. Hoover's function to tell European governments how large their armies ought to be, nor yet to cripple the national defense of the United States to relieve the tax burden of the wealthy during a depression. If Mr. Hoover has no duty or power to do anything constructive about unemployment, he has no obligation to do anything destructive of national defense, either in his own country or elsewhere.

Disarmament, and not peace, has been the subject of the foregoing criticisms. The contention has been simply that disarmament would aggravate rather than relieve the depression. As for the relation of disarmament to the maintenance of peace, that is another matter, about which it seems fitting at this point to interject a few paragraphs. This is done because some critical readers may say, "Granting the argument that

disarmament might further depress trade, would such additional depression not be justified by the contribution which a considerable measure of disarmament would make towards the keeping of the peace?" This book replies that cutting down military expenditures would reduce employment and welfare without thereby lessening in any way the danger of war.

The author may not be called an advocate of war. He boldly proclaims that, given the chance, he would have voted against every declaration of war ever made by the American Government, except that of 1776. His attack on the American disarmament thesis is open to criticism, but not that the author is a militarist. As for disarmament in the present world situation, this book denies *in toto* the claim, so far unsupported by any historical evidence, that the smaller the standing army, the less the danger of war and *vice versa.* This book holds quite simply that armies and navies are the instruments and not the causes of war. American bankers and idealists, not American soldiers by profession, got us into the last war. American career officers, in largest part, have always had a traditional antipathy to most of our late allies, and particularly to the British, as the latter well know.

Suppose all the nations of Europe from 1900 to 1914 had maintained armies and navies just one-half as large as those they did keep, what difference would it have made in August, 1914? The answer would seem obvious: during the opening phases of the war, operations would have taken place on a smaller, though possibly a more active scale, while the belligerents were augmenting their effective forces. The war, however, would have started when it did, had military effectives of the respective belligerents been less in any given proportion. The fighting power of one side would have been expanded during the war to the maximum of the potentialities of that group of belligerents, as it was expanded. And the fighting power of the other side would have been raised above that of its enemy's maximum potentialities to a sufficient extent to destroy the enemy, as actually happened. And, thus, must all wars end that are fought out.

Were all armies and navies suppressed entirely in the next twelve months, there is every reason to suppose that the dangers of war would be somewhat greater than at present. For one thing, the inequalities between nations in different stages of economic development would be greatly increased. Nations like the United States, England and Germany with a marked capacity for the rapid development of a fighting machine would enjoy a tremendous advantage over nations like France and Russia if all nations were disarmed down to a police force basis. Standing armies and navies make it difficult for the industrialized nation with a large merchant marine to get the jump on the agricultural nation.

This book formulates three specific charges against the standard American government thesis of disarmament: The first charge is that of intellectual dishonesty; the second charge is that of moral cowardice; and the third charge is that of subserviency to the selfish and unpatriotic interests of international bankers who prefer foreign trade on credit to domestic trade, from which they can take no such cut as they levy on foreign trade and financing.

The intellectual dishonesty of the American thesis of disarmament for European governments on an alleged *pari passu* basis with the disarmament to be effected by the United States consists in ignoring the following two groups of facts: (1) The United States enjoys an unusual degree of geographical security, being threatened by no contiguous military power. (2) The United States has tremendous offensive advantages for war making against European powers. We can mobilize our full effectives somewhat leisurely, while three thousand miles of ocean afford us an overwhelming defensive advantage against the attack of any enemy.

In a long drawn-out fight, we should have the advantage of tremendous resources in food, raw materials, industries and man power. Even without command of the seas, we could inflict on the sea-borne commerce of our enemy greater losses than we should suffer from similar attacks. Intelligent Europeans understand perfectly these facts and they are not inspired with

better peace feeling by American advocacy of an intellectually dishonest disarmament thesis, which draws invidious parallels between the size of our standing army and that of, say, the French standing army.

Moral cowardice is implicit in the American advocacy of disarmament as a substitute for justice in international relations. Obviously, we can never do anything positive to advance the cause of justice in Europe. On the contrary, we have done everything in our power since 1917 to promote injustice in Europe. Instead of allowing a European war, in which we had no legitimate interest, to be fought out by Europeans, to what would have been a comparatively fair "peace without victory" of mutual exhaustion, as Mr. Wilson, at first, wisely favored, we caused the war to terminate in an overwhelming victory which yielded a peace of shocking injustices. Having inflicted on humanity this victory, we could, thereafter, do nothing effective at Versailles to diminish the injustices perpetrated by our victorious allies. Since Versailles, by insisting on war debt payments, as well as by financing with loans their delivery, we have further done our utmost to thwart any mitigation of the economic injustices of the iniquitous peace which we really gave to the world.

All this being true, it is a piece of moral pusillanimity for us to preach disarmament to the victors and victims of that peace. The victors, as they well know, being realists, can defend only by arms their security under the existing régime of injustice which we enabled them to create. The victims can end these injustices only by blood and iron. For both purposes armaments are indispensable. We can offer no alternative for war, nevertheless, we present a bill for the payment of impossible amounts of money and with this bill we have had the effrontery to tender the advice to Europeans that, once we were being paid, they should disarm, forget the war and be good children. It is moral cowardice to demand disarmament without concerning one's self with protection and justice.

Most significant, however, is the charge that the American disarmament thesis is largely inspired by considerations of capi-

talistic self-interest. In measure as the national defense tax burden of rich Americans or Britishers could be reduced by reason of general disarmament on the Continent, British and American investors would have that much more capital available for making foreign loans with which to enable American and British manufacturers to wrest foreign markets from Continental manufacturers. It is important, in this connection, to bear in mind that American and British manufacturers are now governed largely by the international bankers. These manufacturers must also, in so far as they depend on foreign trade, require the placing by their countrymen of large foreign loans. Otherwise, American and British manufacturers cannot sell many classes of goods abroad in competition with Continental manufacturers who have lower production costs than America or England. In measure as Continental governments might be obliging enough to reduce their armies and navies, and especially their submarines and light cruisers, American and British taxpayers would be enabled to finance exports to compete with Continental industries. Naturally, everybody, outside of the United States, who gives this problem any thought, understands the facts perfectly.

American manufacturers should be told that there is as much money to be made furnishing supplies for the American army and navy as in producing exports. American and British labor may also be told that the workingman is better off to have *x* units of his production consumed by his fellow countrymen in the maintenance of an army and navy, than he is to have the same *x* units given to foreigners through loans by investors. So far as future peace is concerned, the workingman can rest assured that the loans will lead to war more surely than a standing army without loans. An army has not got Switzerland into wars. The Boer War, the present war of the United States on General Sandino in which over 100 American marines and over 3,000 Nicaraguans have uselessly lost their lives, or the present war of the Japanese on the Chinese in Manchuria are all concrete modern examples of the protection of foreign investments. Of course, the United States and Japan do not call

these little affairs wars; they are merely campaigns against bandits waged for the protection of American or Japanese lives and property.

This book asserts, therefore, that the American plea for European disarmament is not mainly concerned over peace, justice nor yet social welfare. It is largely inspired by a selfish, unpatriotic American capitalism which imagines that it could, in the present state of world trade, use the economies realizable through a universal reduction of armaments to pile up larger accumulations of wealth by investors. These savings, it is thought by the international bankers, would serve to promote exports in the form of foreign loans. This book contends that peace is not advanced in such ways. Peace must be created in the hearts of men by peaceful ways of thought and behavior. Where commerce is concerned, this means fair barter trade and not credit-financed international trade warfare.

For the seeker after peace along the Aryan Path or the way of the Sermon on the Mount or some other system of ethics, this book has the deepest respect. The American disarmament thesis lacks any such moral basis. In this connection it is recalled that the world's teachers of peace have always had something more creative to offer than disarmament proposals. This book observes that, as between the soldier and the business man, welfare, peace and progress will be better served under the leadership of the former. Unlike the business leader, the military chief recognizes an obligation to take care of his men as long as they are willing to follow and not merely as long as the leader can exploit them with profit. Soldiers can be adequate spiritual leaders. Profit makers cannot lead a people. Profit makers are against and never with the people. Cæsar gave the world long periods of peace and left to the barbarians of northern Europe a permanent heritage of Roman law and civilization. Napoleon gave the world a model code and the impulse to the codification of laws. Shylock, draped in the American flag and proclaiming the platitudes of Wilsonian idealism, has given the world what? Unbearable war debts, the present depression and the Young Plan. A generation hence

when Mr. Wilson's League of Nations will be only a memory of futility like the Holy Alliance, the gifts of a Cæsar or a Napoleon or a Lenin will still enrich the heritage of the race.

It may seem that this chapter has wandered from its point: the question whether foreign loans are necessary for prosperity. The fact is, however, that there is the closest unity between the argument for foreign loans and the plea for domestic economy, low taxes for the rich and small expenditures by government. Mr. Hoover's taxation policies, designed to favor the rich and to stimulate foreign investments, impose the necessity of large foreign investments to maintain full domestic employment. And, conversely, if large foreign investments are to be made, Mr. Hoover's tax economies for the rich must be followed in order to enable them to make foreign loans. Foreign loans and Mr. Hoover's tax policies are mutually complementary.

This is why it happens that when world conditions so shake the confidence of American investors in foreign loans that capital exports cannot be kept up, the whole British-Hooverian system goes awry, and the American people suffer the troubles of foreigners exactly as though such misfortunes were their own. It is apparent in the present situation that Mr. Hoover cannot conceive of any solution of America's problem other than to have conditions abroad quiet down sufficiently to permit the bankers to mislead American investors into a renewal of foreign loans. They are the keystone of the only economic system Mr. Hoover knows, and, unfortunately, the people of the United States have been chained since 1915 to that system.

In his message to Congress on December 8, 1931, President Hoover, after reciting the tale of the world's troubles, laid on them most of the blame for America's woes. Mr. Hoover said of these world disorders: "The chief influences affecting the state of the Union during the past year have been the continued world economic disturbances. . . . They have increased unemployment and greatly embarrassed our financial and credit system." Mr. Hoover was only too correct in these statements. Washington and Wall Street have cooperated so perfectly

since 1917 in playing the old British foreign loan game, that, as things are now run, the United States can have full employment only if it is able to throw away hundreds of millions of investment capital every year in foreign loans. Mr. Hoover's only contribution must be reduction of taxes and a renewal of inflation with accumulated savings, largely in the field of foreign loans. Unfortunately for him—and he is hardly to blame for it—a lot of troublesome people all over the world have continued to make so many disturbances that he and Wall Street have not been able to restore American confidence—not in America, oh, no; but in foreign countries. Consequently, we might as well not have our vast domestic market.

Since America discovered Europe in 1917, unhappily for both, we have integrated, through foreign loans, our economic life with that of the world at large to such an extent that we must now suffer, not only the consequences of all our own mistakes, but also the consequences of all blunders committed anywhere. This is international cooperation, but is it common sense? It suits our New York bankers, delights the liberals and conforms to the classical economist's pattern, but who feeds the unemployed?

CHAPTER XXII

WHAT IS WASTE?

THE argument of this chapter is that the United States needs more waste and that waste at home is preferable to foreign loans as a generator of prosperity. The question at once arises, What is waste? An attempt to answer this question occupies most of the present chapter, which seeks to make two points: First, all consumption is waste. Second, the term "waste" is used to describe any expenditure of money or effort which the person using the term does not approve of.

In physiology, health is a condition of efficient waste replacement. In business economics, health is a condition of efficient waste prevention. Invalids have a minimum of waste. Healthy vigorous people have a maximum of waste. This chapter holds that economic health is synonymous with a high percentage of waste and waste replacement.

The argument advanced by this book for government expenditures from taxation as a substitute for foreign loans is invariably met by the charge of waste. It is, therefore, essential to give some consideration to the ideas that are associated with the use of this term "waste." Let it be said at once that, in the view of this book, anyone has a perfect right to object to any use of money whether by government or by private spenders. But it is no reason for such an objection to call an expenditure a waste. That is merely a way of saying "I don't approve of it," which gives no reason.

We shall now talk waste in terms of the concrete. It used to be the usual thing in America for people to emotionalize over the cruel economic losses suffered by France as a result of the war. So far as the loss of human life and the sufferings experienced by human beings are concerned, this book shares the strongest feelings against war. So far as the economic con-

sequences of war are concerned, the realist cannot see eye to eye with popular views.

The dean of living French economists, Professor Charles Gide, with that lucidity which is the crowning glory of French culture, has uttered probably the most sensible words yet pronounced on the subject of war waste in an article entitled "What are we to understand by the cost of the war?"[1] In the concluding paragraph of his article, Professor Gide says: "If France supported so well the terrible waste [gaspillage] of the war, it is because the waste of war only replaced the waste of peace. Whether thousands of chauffeurs, instead of driving their masters on pleasure or business, transported munitions on the sacred road to Verdun; or whether thousands of gallons of alcohol were consumed in the manufacture of munitions instead of in the intoxication of human beings, the national economy did not suffer anything therefrom. . . . Everything happens [in war] as if everybody, owner, employer and worker had been requisitioned and obliged to furnish gratis their land, capital and labor."

Had there been no war, or had there been a war with no devastated regions, and had France been left by a communist revolution in Russia with no Czarist Government to which to lend money continuously, the recent state of French trade would have been as miserable as that of British trade. With no devastated regions to rebuild, France would have lacked a reason acceptable to the French bourgeoisie and peasantry for a necessary amount of waste. The French peasant instinctively practices Mr. Hoover's philosophy. He, that is, the peasant, will wash in cold water at the pump so as to be able to buy a foreign bond to build model houses for foreign workers or pay for munitions for foreign governments. But for the devastated regions, French economy would have kept down waste (American bankers deprived the French of the opportunity of throwing their money away in South America) to such an extent that the state of French industry would have been lamentable. This is not an amusing paradox. It is prosaic reality.

[1] *La Revue d'Economie Politique*, January-February, 1931.

The tragedy of England since the war has been that the war left her with no devastated regions. The Australians did their best at wasting money, but they could borrow only 90 per cent of the interest they had to pay British investors, so this waste was not helpful to the British. Britain was even so unwise as to keep the confiscated German merchant ships, instead of sinking them promptly. From Versailles to the collapse of sterling in the fall of 1931, Britain has had only one piece of good luck: the French occupation of the Ruhr. That event created a year's prosperity for the British coal export trade and incensed British opinion against their French ally. A war which leaves a capitalistic state with little devastation to repair has not fulfilled its economic function. Total deposits in all banks, including savings banks, measured in gold value, from 1920 to 1929, increased 30 per cent in England and 75 per cent in France. The war did right by France and little Belgium, as their subsequent prosperity witnesses.

Arguments that war is uneconomic are absurd. There is no valid economic argument against war any more than there is against moving pictures, grand opera, silk stockings, cigarettes or golf. If people did not like to fight, there would be no wars. If people want to fight, the costs incidental to the gratification of this most normal of all human cravings, the most universal after hunger and sex, are just as economic as the costs of any other human satisfaction.

War expenditures may be called uneconomic in so far as it may be shown that the unit cost of killing enemies is higher than it might be with the use of other practicable and more efficient killing methods. The only economics there is to war consists in getting most people killed for least money, or winning the war at the lowest economic cost. To ask what good it is to anyone to win a war makes an interesting philosophical question. But the same is true of the question, What good is a pipe organ in a church? Good Presbyterians in Scotland for a long time considered pipe organs sinful in churches.

From the point of view of the killed, being killed may be considered as somewhat uneconomic or wasteful, though it is

not altogether likely that many people about to be killed would express their objections in these particular terms. Similarly, men thrown out of work by an efficient machine or put out of business by a stronger competitor may be disposed to view these experiences as distinctly unfortunate. Again, however, it may be observed that they would probably base their protests on other considerations than those of economy and the avoidance of waste. From the point of view of killers for their country or other less worthy causes or from the point of view of manufacturers displacing a $5 a day man with a $1 a day machine, success in the struggle for survival achieved by killing or throwing men out of work is most highly economic in a thoroughly valid sense. The only point to this paragraph is that there is no such thing as objective economics.

Economics of itself has no concern with proving that croquet is a better sport than bull fighting; that killing people in badly safeguarded industries is preferable to killing them in romantic warfare; or that selling bonds is a nobler calling than sailing gunboats. It is a proof of the moral bankruptcy in many present-day statesmen and liberals that when they want to denounce war they have to use economic arguments. When Lowell's character says that war is murder, he is talking sense. When Nietzsche sees in war the flowering of some of the finest values of the race, he is displaying civilized appreciation. When a modern liberal calls war a waste, he is making a trite statement of an obvious but wholly immaterial fact.

Waste is the life of trade and even of business profits. It is estimated that the sum of 30 billion dollars a year, or over a third of our national income, is spent on luxuries. The entire female population could, for example, get along quite well with two or three new uniforms a year, which could be made on one or two models, in a few standardized weights, colors and sizes for $1 a garment. Several billion dollars now wasted every year on women's apparel might thus be economized and spent "productively" on something else, such as tombs for our ancestors or hundred-story buildings.

If we could but develop a war game at which armies could

play without hating or hurting anyone and without diminishing any of the waste usually attendant on war, we should have found a perfect solution for our present economic troubles. Merchant ships, loaded down to the water line with materials, could be navigated by wireless and sunk by competing navies. Instead of tearing down a perfectly good hotel (that a lot of people had got used to and come to like) in order to put up a thousand-foot white elephant which cannot earn its expenses, we should have two rival armies evacuate and bombard two unsanitary or merely unsightly villages.

The army which did the best job, according to the rules of the game, would win a handsome trophy and several bushels of appropriate decorations. After the battle, the victorious army would go off and celebrate for several weeks its glorious feat of arms, while the defeated army would go into intensive training. Both courses would further stimulate trade, provide agreeable activity and make everyone happy. Profiteers and workers would at once get busy and have a splendid time rebuilding a model town, while the evacuated inhabitants would be paying exorbitant rents in neighboring towns to the further encouragement of business.

As fast as the costs of building new towns or producing munitions were reduced by the evil cunning of efficiency experts, always plotting against the workingman's job, the gallant army officers would invent more expensive ways of destroying property and better reasons for a new outbreak. Technological unemployment would thus be unknown.

Humanity would have its spiritual needs for a perpetual conflict between angels and devils satisfied by the warfare between the grand army of the people and the ignoble industrial engineers. As in all good demonology, the angels would always be winning, but the angels and the devils would never cooperate. It doesn't do to have the angels and the devils get together. If business men are the angels, as appears to be the present hypothesis, then the devils should get on the job. Every angel must have his devil to waste and destroy for him.

To return to the concrete case of France from these flights

of allegory, let it be said that devastated France had no serious industrial depression from the war until 1930 and that the present depression is felt less there than in other countries. Physical production in France showed a 29 per cent increase in 1929 over 1924; for England the increase was 12 per cent, and for the United States only 24 per cent. What is the explanation of the French post-war prosperity? Largely policies of waste and extravagant waste replacement.

These policies were greatly assisted by currency inflation and subsequent devaluation of the franc from 19.3 cents to 3.91 cents. This measure swindled, to use a term sanctioned in this connection by Professor Jèze,[2] the leading French authority on public finance, investors of the *rentier* class but stimulated industrial activity and production. Currency inflation is no more of a swindle than selling overpriced securities as our bankers did. Moreover, currency inflation is much less harmful because there is no interest problem to leave an aftermath. The people whom currency inflation ruins are not producers but *rentiers*. The process sometimes forces them to go to work again. The people whom credit instrument inflation cripples are producers like small farmers and wage earners, buying homes on mortgage and everything else on credit.

The British free traders and international bankers across the Channel did not go in for these unsound French inflationist ways. They thought they were in possession of a special revelation received by Manchester in the eighteenth century covering the subjects of trade, gold and credit. In 1923, obeying the dictates of bankers, business men and money lenders, the British Government committed a great blunder. It deserted the cause of the debtor nations worthily sustained by a wise France. The British thought they were wondrous clever fellows when they made the opening breach in the solidarity of the debtor nations and won the plaudits of the American bankers and statesmen by accepting an onerous debt agreement with Washington at an interest rate of 3.3 per cent. France obdurately held out as long as she could against our pressure and in the

[2] La Date de Remboursement de la Dette Publique, Gaston Jèze, page 122.

face of the defection of her ally, Britain, but finally obtained an agreement reducing the interest rate to 1.6 per cent. But for the British betrayal of the interests of the debtor nations, there would have been no debt ratifications and a satisfactory cancellation of debts and reparations before the end of 1925 in all probability. The world would have been a happier and better place, and quite as much for the United States as for the debtors.

Great Britain committed the further blunder, dictated by the same banker interests and considerations, of restoring in 1925 the pound sterling to its pre-war parity, thus fettering British production with an impossible load of debt and establishing production costs wholly out of line with those of Continental competitors. The French, of course, had wiped out 80 per cent of all debts by a stroke of the legislative pen. This was really an inequitable way of levying several billions of dollars on bondholders.

If the Alger type of economics had any validity, England would in the midst of the world's greatest depression be harvesting the delectable fruits of paying her debts to the letter and discouraging waste, while France would be reaping the whirlwind. Instead, the proud old Bank of England has had to go begging loans of France and the United States and finally to haul down, on September 21, 1931, the British pre-war gold standard forever. In its present hour of misfortune the British Government might well paraphrase the words of a great sixteenth century cardinal, and say that if it had served its producers as faithfully as it served its money lenders, it would not have been reduced in its old age to begging loans of the central banks of the United States and France to no finally useful purpose, except for the lenders. The credit policies of England may inspire admiration in some quarters. Suicide is often a *beau geste*. But realists with humanitarian leanings must reserve their admiration for policies which put honesty to the people before honesty to the money lender.

The French have not been saved by superior financial craft. They have never possessed any. They have been saved because

they lacked financial experts, and because their destinies have been ruled by militaristic nationalists concerned over national security and selfish politicians interested in pork barrel financial legislation. With such elements in control, and acting as a balance to the natural habits of thrift of the French people, the prosperity of the country was assured. Nothing can be more disastrous to a nation's prosperity than the direction of business men and investors, interested in economy, preserving credit values, maintaining contractual rights and avoiding waste.

In conclusion, it remains to emphasize the statement that no defense has been made of French fiscal policies. Nor have they been attacked. Likewise, the destruction of property by war has not been extolled as the only or best means of creating work for the unemployed. On the contrary, it has been maintained from the outset that there are better ways of creating a satisfactory demand for production than war or foreign loans. The benign consequences of war waste have been realistically discussed by way of showing that government can increase economic activity without any other limit than that fixed by a people's resources and capacity to work.

It cannot be said that war is not practicable. That is the sovereign merit of the argument developed in this chapter. Social expenditures, it is alleged, are an impractical waste. The answer is, How about war waste? The World War was not ended by an economic breakdown, as was so often predicted. The war was won by sheer force of superior numbers and fire on the western front. Allied superiority was, of course, partly economic, in that they were able to fire, towards the end, ten shells to the Germans' one. But the defeat of Germany did not result from the incapacity of Germany to maintain indefinitely the maximum production attainable with her resources. Defeat came because her productive resources were outmatched by those of the enemy. Wars may be begun by statesmen, bankers and idealists, but they are ended by soldiers. Economically there is no conclusive reason why the world might not have a hundred years' war today, if the contestants were matched with sufficient evenness.

It is proper to oppose one type of expenditure and to favor another. It seems a crime against humanity, and even against that somewhat intangible thing called business, to oppose adequate increases in public expenditures on the ground that they would be wasteful, when it is perfectly evident that there is no other way of effecting the needed amount of spending. The rich won't spend enough; the government must.

CHAPTER XXIII

ARE FOREIGN LOANS PRODUCTIVE?

LET it be said at the outset that the term "productive" is merely an expression people have in a business civilization for indicating strong approval of the object to which it is applied. In plain fact, the terms "productive" and "production," as used in the realm of economic affairs, may have one of two sets of meaning: they may refer to the creation of goods or services which satisfy human wants; or they may simply denote profit making. When a man calls foreign loans productive, he merely means that he approves of them. In this connection it should be remembered that business men usually find anything they make money at, productive, and anything they cannot make money at, unproductive.

It is important to keep in mind the distinction between productivity in the sense of profit making and productivity in the sense of satisfying human wants. For instance, the drug traffic is both productive of profits and productive of human satisfactions. On the other hand, the cotton and leather goods trade has been unprofitable for some years past, though it is to be assumed that people derive considerable satisfaction from the use of cotton and leather goods. Now, it is proper to disapprove of the drug traffic, but it is silly to say that it is unproductive. On the other hand, it would seem proper to approve of the cotton trade, and it would hardly be truthful to say that it was productive of profits.

With regard to foreign loans it becomes evident that productivity is a rather confusing idea. A profitable enterprise is likely to produce a satisfactory income for investors. But if one means profits, why not say profits? When a foreign investment is a government loan, as most of our investments are, there is usually no question of profit. Broadly speaking, the more injurious to human welfare an investment of public funds may

prove, the surer it is to be productive of an immediate money income for the state. State lotteries, practically speaking, never lose money for the state. The sale of primary public instruction is not usual, but where it does occur, it never pays.

It is not a paradox to say that for a century British war loans have been paid punctually without default, while, during the same period, several billion dollars, or the majority, of government public works loans in South America, Turkey, Egypt and certain other countries, like Portugal, have been in default. History, therefore, proves that British wars are productive for investors while South American railways are not, that is when financed by the state. These are facts.

What do these facts prove, if anything? They indicate that any notion of productivity in connection with foreign loans is practically useless to an investor. The only factors of significance for investors are the character of the borrowers and the future trend of events, especially of international prices. About these factors, the bankers are usually as silent as they are ignorant. Instead of recognizing that all investment is a pure gamble and seeking safety in diversification, bankers and economists will pore solemnly over neat tables of figures proving such facts as that coffee grows in Brazil or that copper is mined in Chile. Of course, intelligent people learned all this as children and have not since found the information of any particular value. Neither have the bankers. American bankers have no quaint little idols to be reverent before, so they must satisfy their innate craving for worship in their reactions to statistics.

By way of demonstrating statistically the absurdity of correlating productivity with foreign loans, the following German statistics are submitted:

Year	Index of Total Physical Production	Total Number of Unemployed on the Dole
1924	100	701,000
1926	115	2,028,000
1927–1928	145	1,300,000
1929	146	1,916,000
1930	115	3,145,000
1931 November	MORATORIUM	4,900,000

It is evident from these figures that German production increased during the years of German borrowing abroad. Foreign loans may have contributed to this increased production. At the same time, it should be recalled that in 1913, out of a population of 67,000,000, Germany had 23,400,000 gainfully employed, while in 1931, out of a population of 65,000,000, she had 33,000,000 gainfully employed. But what has all this increased production had to do with German capacity to pay foreign debts? This question will be answered throughout the ensuing three chapters. We shall not formulate a doctrinary answer, but endeavor to enable the reader to reason out a fairly obvious reply for himself.

Let us now state a few concrete facts, so dear to bankers and economists, about productivity. Australia, Brazil and Chile, in round figures, to avoid statistical minutiæ, have 4, 2½ and 1½ billion dollars, respectively, of borrowed foreign capital invested productively in their territories. Since the war these countries have imported capital in excess of 1, 1 and ½ billion dollars, respectively. These will serve as facts, of a statistical nature. Brazil and Chile are in default on their foreign debts, and Australia is, all but in name, at the end of 1931. At this time seven other nations in the world are also in default on foreign obligations. These are more facts.

Now let us run over a few facts as to productivity in connection with these three heavy borrowers. Australia between 1910 and 1914 produced 90 million bushels of wheat per annum. From 1925 to 1929 she averaged 160 million bushels a year. Wheat is the leading Australian export. Other Australian exports will also show a large post-war increase. Take Chile, that unfortunate country in 1913 was exporting 143 million dollars' worth of goods and about 22 million more than she imported. The yearly average for the three years 1927-1929 was 239 million for exports and 83 million for the favorable balance of exports over imports. In 1913, Chile produced 19,938 tons of copper, while in 1929 she was producing 239,430 tons. In 1913 the public debt was 229 million dollars, about half of which was foreign. By the end of 1929, thanks to New

York bankers, the public debt was 457 million of which 284 million were owed in New York and 164 million in London or elsewhere in Europe. The Brazilian facts will be discussed separately.

There are just two really significant facts about the Chilean and Australian defaults: the drop of copper from 18 to 6 cents a pound and of wheat from $1.30 a bushel to 50 cents a bushel. Until bankers can give facts about future prices, investors would do much better to consult gipsy fortune tellers than to read circulars on the credit of foreign countries whose securities they are contemplating as a purchase. The average man is less likely to act foolish on the advice of the gipsy than on the information prepared by college graduates in economics.

Now we come to Brazil, the prize example of the productive use of foreign capital. Here are some of the more essential facts about production. (The only important fact is that Brazilian coffee is selling at 5 cents a pound instead of 20 cents, as it was quoted for quite a time during the post-war period.) Seventy per cent of Brazil's exports are coffee. On October 1, 1931, Brazil had in warehouse 38,000,000 bags of coffee, of which 12,000,000 bags are to be burned in the next twelve months. The average annual consumption of Brazilian coffee is about 16,000,000 bags. How did Brazil accumulate 38,000,000 bags of coffee and come to produce for some five years prior to 1929 around 25,000,000 bags of coffee a year, when only about 16,000,000 bags were needed? The answer is, productive foreign loans, which, because of the large carry-over added about 20 per cent to the cost of production. The reader will be spared details of the Brazilian coffee stabilization or valorization plan, financed by foreign investors. It will be more illuminating to pursue a series of interesting "ifs," by way of showing the utter folly of productive foreign loans of the post-war period.

If all foreign investments in Brazil since the war, aggregating in round figures about a billion dollars, had been used exclusively to finance fireworks or the destruction of coffee trees, instead of a 25 per cent increase in the number of trees and an improvement in their bearing capacity, the Brazilian

coffee output would have been materially reduced and the 38,000,000 bags of coffee would not have been accumulated. Consequently, the same price levels that were maintained artificially for a number of years by buying and withholding coffee from the market might have been sustained indefinitely by a real shortage of production. Perhaps a slight lowering of price might have been forced by the competition of other producers, who are responsible for nearly a third of the world's crop. Their coffee, however, is of a higher quality, generally, and is produced at higher cost. By limiting production, Brazil could easily have kept her coffee at 15 to 18 cents a pound.

Had Brazil so used her borrowed money destructively, she would have been receiving in 1931 an income of about 300 million dollars a year from the sale of her coffee crop, instead of an income under 100 million. The 200 million dollars so gained would have covered 80 million service charges on the billion dollars borrowed for fireworks and allowed 120 million for the purchase of foreign goods, which cannot now be imported. There is no specious paradox in this "if." It is the logic of the Farm Board's Bulletin "Grow Less, Get More."

Let us now proceed to a second "if." It must not be supposed that because this book opposes productive loans since the war, it would have favored destructive loans. We will make another supposition. Following the World War, when Brazil was swollen with war profits, the Brazilian Government might have prohibited all imports of capital and kept down coffee production by outrageous taxes on any increase in the number of planted trees. Naturally, economists and business men the world over would have denounced this interference by government with the working of the law of supply and demand. Curiously, though, these experts never protest against banker interference with supply and demand through extensions of credit, while these processes are in course. It must be assumed, for the sake of this supposed case, that such policies of government interference with production would not have been considered by the United States as a violation of the Monroe Doctrine and would not have provoked an American inter-

vention in Brazil to protect the right of American citizens to grow as much coffee as they pleased, a right which our laws assure to Brazilians in the United States. Waiving this question, let us proceed with the assumption of a curtailment of production by taxes and a prohibition of foreign loans. What would be the results today?

Coffee would be at least 15 cents a pound, or three times its present value. The annual income of Brazil from the sale of coffee would be nearly 200 million dollars greater than it was in 1931. The annual debt charge would be nearly 100 million less. By now, Brazil would have paid off most of its foreign debt, as of the end of the war. It is, therefore, a conservative estimate to make that, under a no-borrowing, debt extinguishment and coffee restriction policy, pursued since the war, Brazil would not only be solvent today instead of bankrupt, but would enjoy an income in foreign currency from the sale of coffee and other products equal to over a quarter of a billion dollars more than her present foreign income. At the same time, Brazil would not have lost during the past two years some 200 million dollars of her gold supply in a futile attempt to maintain national solvency.

The real point of the analysis just made of two hypothetical courses of credit policy for Brazil since the war is that foreign loans, when they are productive, destroy foreign trade. This, again, is not a paradox. Brazil was able in 1931 to purchase about a quarter of a million dollars less of foreign goods than she could and would buy, if the price of coffee were at a reasonable figure, say, between 15 and 20 cents. By creating overproduction of Brazilian coffee, foreign loans have reduced the purchasing power of Brazil for foreign products. There is absolutely no answer to this argument. Books may be written on the subject, but they cannot escape the simple fact that, as world economy is constituted today, foreign loans destroy trade.

The essence of trade is exchanging Brazilian coffee for foreign goods. The essence of the foreign loan system, after it has been in use for any length of time, is exchanging Brazilian

coffee for interest receipts or bond coupons. Obviously, buying Brazilian coffee with bond coupons does not give work to American workers. The process is fundamentally unsound. Let us now proceed to work out the theoretical explanation of a principle proved by the experience of every single large borrower since the war.

A country like Brazil, in the beginning, has no foreign capital worth mentioning. Foreigners discover there products for which a rapidly growing foreign market can be developed. Foreigners, therefore, quite properly invest capital in that country to develop the production of these commodities. During this initial period, the foreign trade of that country and the lending countries enjoys an agreeable stimulus which, if business men were capable of disinterested reasoning, they would not consider healthy or desirable, but merely a necessary though evil accompaniment of the opening up of a new field of production.

To punctuate the proposition just stated to the effect that foreign loans create rising prices and hectic prosperity, it may be stated that Professor Viner showed in his study of Canada's Balance of International Payments 1900-1913, her great borrowing era, that wages rose from 100 to 148, while in the United States they rose from 100 to 127. In England, the chief lender during this Canadian inflationary orgy, money wages rose from 100 to 103. It will be recalled from Chapter XXI that during the period in question Canada imported 2,546 million dollars of capital.

After the debt-making process for the opening up of the new productive field has run the course of a complete interest cycle, fourteen years if the average interest rate be 7 per cent, the amount of new capital the borrowing country receives each year in fresh investments by foreigners becomes less than the interest payable on accumulated borrowings. This is the point of diminishing returns, or the end of the interest cycle. At this point new loans would have to increase in geometric progression in order to keep pace with interest. And even the speed of light does not increase in that way.

It is at this point, when interest payments equal obtainable new borrowings, that the borrowing should begin to decline, if it has not done so previously. It is then that a start should be made towards paying off the foreign debt of the country. This would not necessarily mean an abrupt stoppage of all new foreign financing at the close of the interest cycle. It would merely mean a start towards a reduction of the foreign investments in the country.

The paying-off process, or progressive extinction of foreign investments, will be marked by depression for both borrowers and lenders, where the amounts involved are large. This debt-paying process inevitably generates factors like falling prices. Of course, the generation of these unpleasant factors may be exceptionally stayed by the operation of more potent contrary forces creating a rise in prices. Thus the World War, principally among the lender countries, enabled the debtor countries like Canada to pay a sack of wheat borrowed between 1900 and 1913 with a third of a sack. This was, naturally, beer and skittles for the borrowers. But foreign loans should not be made on the assumption of something like a war happening to enable the borrowers to pay back $1 with 40 cents. It is precisely because no such event occurred in 1928 that the crash had to come in 1929.

If, to continue the borrowing cycle of the new country, after the point of diminishing returns in borrowing has been reached, the borrowers do not reverse the process, trouble must begin brewing. The brewing of that trouble is, to be quite specific, the genesis of overproduction and catastrophic price declines, rendering all debts unpayable and all credits unsound. This process will now be explained. The explanation, be it noted, is merely the history of the post-war era, so far as foreign loans are concerned. The culmination is the present world crisis.

If loans are continued after the point of diminishing returns has been reached, that is to say, after interest charges have come to equal or exceed the proceeds of new loans, events take a course which will now be described. One of the first effects

to be noted is that the debtor nation, as an economic unit, is deriving from foreign loans the gold exchange with which to pay interest on its foreign debts. This condition may be said to be the root of the evil. It really means that the gold standard is rendered utterly inoperative. Prices are, therefore, completely falsified in the borrowing country, and by sympathy, they are falsified more or less throughout the world, if the phenomena assume large proportions.

In order to keep the theory in close touch with history, it may be said that since the war, Germany, Austria, Australia, Argentina, Brazil, Chile, Bolivia, Colombia, Peru, and Uruguay have been off the gold standard practically every moment of the time except in name. This statement is true because these countries, as well as many others, have not made a practice of shipping gold out of the country to pay interest on foreign debit balances. They have made occasional gold shipments, but most of the time they have relied on gold exchange credits supplied by lenders to borrowers in these countries to balance the international payments.

The significance for prices and production is this: Had gold been shipped, as a proper observance of the gold standard required, a number of important results in the borrowing countries would, automatically, have flowed therefrom. For instance, gold shipments by Germany, Australia, Peru, Argentina or Brazil, in the absence of new foreign loans, would have forced a contraction of domestic credit and thus effected a curtailment of production of speculative commodities and money crops in particular. It would have forced merchants to reduce inventories by sales at marked down prices. It would have nipped in the bud real estate booms in South America and stock market booms in Berlin. It would have forced many debtors to sell assets in real and personal property at lower prices. It would, in short, have kept local prices in line with world prices and thus would have stabilized the local exchanges with gold standard exchanges. It would have settled the reparations question at once.

Thanks to the international bankers, supposedly the high

priests of the gold standard, all these adjustments did not happen. Why? Because foreign loans kept paying foreign debts. Gold was sterilized. Prices remained abnormally or artificially high in the borrowing countries. This stimulated large production of the wrong things. While local prices were kept high, the production costs of the nation were kept abnormally low. The borrowing nation was relieved by the loans of the necessity of paying the interest on its foreign debts or of paying the full costs of government expenditures. Public works were built with borrowed money. Local savings were not absorbed by native government bonds. They could, therefore, be diverted to real estate and stock market booms. Moreover, a great deal of foreign capital went into direct investments in the mining, sugar, coffee, meat, cotton and other extractive industries. These private enterprises went ahead producing like mad for foreign markets quite indifferent to the prices or demand of the country in which production was being made.

Thus we have outlined somewhat sketchily how the process of overexpansion can be carried on for several years by continuous injections into a borrowing country of foreign capital. Between 1913 and 1925 the total world output of raw materials and foodstuffs increased 16% while population grew by only 6%.[1] In the meantime the international bankers, the Department of Commerce and the liberals extolled the cooperation of the United States in the efficient running of the world. It would have been splendid if it could have been kept up. But the processes had in themselves the seeds of their own destruction.

There are other vicious features of the persistence of foreign loans besides the suspension of the gold standard, the falsification of prices and credit values, and the encouragement of unbalanced production. For instance, overproduction of certain export commodities or unbalanced building of public works on borrowed money result in the integration of workers and producing equipment into units which must, sooner or

[1] *The Course and Phases of the World Economic Depression, 1931*, p. 14. Secretariat of the League of Nations.

later, be thrown into idleness. Men who were peacefully and happily working in South America at occupations at which they could have been kept employed indefinitely, like their ancestors before them, were, thanks to productive American loans, drafted by profiteers into industries and contracting enterprises whose feverish activity could be only a transient phenomenon.

For converting peaceful Indians into communists, no better combination could be desired than that of American investors, American bankers, grafting South American politicians and profiteering contractors or producers. The American manufacturer makes a great mistake if he supposes that over the long run these activities of the New York bankers have proved helpful to American foreign trade.

These lending operations accentuate the maldistribution of income or purchasing power, in both lending and borrowing countries, by the simple device of increasing the money lender's share and decreasing the wage earner's proportionate part of total production. The money lenders, at one and the same time, are financing increased production and reducing the ratio of purchasing power to the volume of output, so far as 95 per cent of the people are concerned.

The debtors, not having had to reduce production by reason of the free play of gold standard price adjustments and the payment of interest in gold, or its equivalent in goods, created a situation which, by the middle of 1928, was pregnant with disaster. Speculators are always first to read the handwriting on the wall. They, therefore, precipitated the price decline and accelerated its velocity once the movement was started. This they did by selling short.

In describing the march of the borrowing country towards the inevitable debacle, one must mention the culminating factor of the shutting off of new loans just as the pinch of falling prices began to be felt. Here is a nice meeting of two adverse factors. First, accumulated interest charges overtake the amount of new loans, because interest charges are growing by geometrical progression. Second, foreign money income is declining by reason of falling prices. Then comes the unwillingness of

foreign investors to put up each year the usual amounts of new money needed to continue the borrowing cycle. All the elements of the tragedy are complete. The loans are no longer considered productive, when, as a matter of fact, that is just what has been the matter with them.

The wheel comes full circle. Default on interest-bearing obligations and non-payment of dividends on other investments, followed by a gradual or eventual extinction of debts and common stock equities, must reduce the foreign debt of the borrowing country. In these anti-social ways is accomplished what common sense indicated should be done through payment out of earnings.

Now for conclusions: Under the capitalist or price and profits system, there is only one way to avoid overproduction of certain commodities, and that way requires little conscious management, though its observance may call for much preventive action. That way is a pay-as-you-go-or-expand policy. As soon as production in a new country reaches a paying stage, further expansion in that country should be financed out of earnings, that is to say, without increasing the net debt of that country to foreigners. And, in a near future, a start should be made towards the reduction of the country's debt to foreigners. Now that the era of frontier countries has been passed, for thirty years, it is evident that the ideal state of world trade relations is one of balanced debits and credits and balanced income on capital account. No further proof need be advanced to show that there is no necessity for financing increased export production in any of the new countries.

Great emphasis must be laid on the fact that the critique just developed has not denied that foreign investments ever served a useful function in the world's history, as many hasty critics of this book are almost certain to allege. So far from being opposed to foreign trade, the burden of this critique is that foreign loans in the twentieth century, being carried beyond the period of gestation of new production in undeveloped countries, are harmful because such loans cripple foreign trade. Importing a billion dollars a year of foreign commodities in

return for the same amount of bondholders' coupons is good for nobody.

Never in history were international loans less justified by any rational consideration than in the period following the World War. Every South American country had an excessive quantity of gold and foreign credits as a result of war profiteering. As late as 1927 the Argentine had 600 million dollars in monetary gold or $60 per capita as against a little over 700 million in gold or some $16 per capita for Great Britain, which still had hopes of remaining the world's banker.

When the war closed, the conditions of currency instability were precisely reasons for an avoidance of borrowing. They were reasons for reestablishing the gold standard, balancing budgets out of taxation, and exporting some of the excessive quantities of war-gotten gold, while prices and credit were being deflated to the world gold standard levels. Instead of making such obvious adjustments, for which these countries were never in a stronger position, the South American countries began getting in touch with bond-selling American bankers and their advance agents, the academic experts on finance. Under the guidance of these two money-making groups of individuals, the South American countries proceeded to sterilize their gold; to obtain huge loans from the American people for balancing budget deficits and extravagant expenditures; and to help prepare the present collapse of world credit. They pegged artificially their currencies with borrowed money and deceived American investors into believing that they were on the gold standard. The responsibility is shared by the grafting South American politicians, the New York bankers, the American Government, which either winked at or openly approved of these operations, and American professional financial advisers who allowed their names to be used as a bond-selling argument and did not disclose to American investors the facts as they knew them to be.

These foreign investments have been productive of excessive quantities of unsaleable raw materials; of the means of financing war debt payments; and of the elements of the present

world crisis. They have not been productive of profit for investors or of welfare for the world. And, what is most important, these loans could not, on the scale on which they were made, have been managed in a way to avoid the present disasters. The reason the post-war loans, as a whole, had to end disastrously is that there was no need for them, except to finance war debt and reparations transfers insisted on by the United States Government. Our excessive loans to South America were needed to balance the international accounts of our war debtors in Europe and to unbalance both the raw material production of South America and the trade of the world.

CHAPTER XXIV

CAN FOREIGN LOANS BE REPAID?

THE answer is, No. As a practical matter, foreign loans cannot be repaid under the business system, except in the event of war or some wholly unforeseeable new economic development creating an abnormal demand for consumption goods. This chapter, of course, merely proves with a different set of reasons what has been proved in the preceding chapter. This proof is important for the completion of the picture. The last chapter explained, in some detail, the mechanical impossibility of foreign loans producing in the borrowing countries the money of repayment, though such loans do encourage the production of an unsaleable excess of exportable commodities. This chapter shows how foreign loans make it impossible for the lending countries to receive payment in goods.

In the lending countries the mechanical difficulties of repayment are these: There is insufficient purchasing power to absorb: (1) the necessary imports surplus in redemption of bond coupons; and (2) a volume of domestic production essential to the maintenance of a minimum-with-safety employment of home labor and capital invested in industrial production. Falling prices wreck the economy of the capitalistic country trying to take foreign goods in exchange for paper coupons.

The argument should be followed without undue resentment against the author for stating clearly a number of unpleasant paradoxes, which, it should be recalled, he did not create. The reader should bear in mind that starvation in the midst of plenty and the burning of unsaleable surpluses of goods are also paradoxes. Practical business men created these paradoxes. A realist now analyzes them. He deserves credit for having expressed the view that these paradoxes are not essential to the maintenance of a modified system of capitalism!

We now plunge into the question, Can foreign loans be repaid? or, rather, Can payment be received? It must be understood that the term "foreign loans" is often used loosely in order to avoid a frequent all-inclusive enumeration of every type of foreign investment. Most foreign investments, as a matter of fact, do take the form of direct loans. The term foreign loans as used, alone, must be construed to refer to the totality of our investments abroad.

It is important to keep the fact clearly in mind that the payment of individual loans does not constitute payment of foreign loans. An insolvent debtor may, for some time, go on paying debts when due, by the simple expedient of borrowing fresh money. The debts of the individual states, companies and persons of one country to foreigners must be regarded collectively as the debt of that country to foreigners, because real payment has to be effected by an exports surplus of that country as an economic unit.

A nation's interest and dividend dues to foreigners must be paid out of its production, that is to say, from the sale of its goods, services or gold to foreigners. A nation that has to rely on foreign borrowing over a series of years to balance its international income and outgo is insolvent. The alleged value of the country's assets has absolutely no relation to the fact of its incapacity to meet current obligations; not any more than the cost or reproduction value of a railroad operating with a continuous deficit has any bearing on the fact that the road is bankrupt. Germany has been bankrupt since the war, and American bankers have sold bonds of a bankrupt country on fundamental misrepresentations.

In strong dissent with the position just stated have stood the American Government and bankers, developing a theory and practice whose logical culmination had to be the collapse of world credit. They have said, in effect, something like this:

"A debtor nation, like a debtor company, may for a time be unable to meet out of current income its current obligations. In the case of a nation, it may be unable to obtain, solely through the sale of its products and services, the means of

such payment. But, of course, as the debtor nation's physical assets are worth much more (to whom?) than these dues to foreigners, and as it is to be taken for granted that conditions will improve (note well, this was from 1924 to 1929 during the height of the world's greatest known trade boom), such a nation should be generously assisted by wealthy nations with loans (at the generous rate of over 7 per cent) during a reasonable period until the embarrassed debtor nation may become sufficiently rehabilitated to pay its way and slowly to repay these initial advances."

Further comment seems unnecessary on this position. This book charges that the main cause of the world depression is American financing, at home and abroad, by means of interest-bearing debts, of expenditures in excess of money income. It asserts that, if money outgo today cannot be balanced by money income, borrowing will not effect a correction in this situation tomorrow or day after tomorrow. The world situation proves this assertion. The undertaking here is to develop one explanation of its truth.

The only mechanism for effecting real payment of interest or principal on foreign investments is an imports surplus. Uncle Sam's bookkeeper, if he had one, would make the following entries in his ledger on account of an imports surplus: He would credit world borrowers with the amount of the imports surplus, by which their indebtedness to Uncle Sam would be reduced. He would debit Uncle Sam's account, called capital, with the same amount. For us, all our imports are debits and all our exports are credits.

It may be remarked, in passing, that, if foreigners were to invest as much in the United States as we have invested abroad, the process of their doing so would register practically the same effects as if foreigners repaid their debts to us. Two men who owe each other $1,000 really owe each other nothing, though some minor importance might attach to possible differences in interest rates or repayment dates. The cancellation of our international creditor position by the mere process of equivalent investment being made by foreigners in the United

States need not be given serious thought for the present. But, should a trend in this direction develop, it could continue only through an imports surplus in goods, gold and services, which is the process here being discussed. It should be borne in mind that capital movements are the symbolic counterparts of movements in the net balances of imports and exports. Capital is a bunch of symbols or fictions. Exports and imports are tangible realities.

An examination of Table 3 on page 222 will show that our total exports surplus over the eleven years, 1920-1930, was 473 million dollars on goods, gold and services, exclusive of interest, or practically barter trade. But, if interest be included among the services, our total exports surplus over these years was 7,737 million, or roughly 700 million a year.

It is evident, therefore, that to have had an imports surplus sufficient to transfer our interest dues since 1919, we should have had to take approximately 700 million dollars a year more in imports than we actually received, or, of course, to decrease our exports by 700 million while maintaining our imports as they were. In this way we should have been receiving the income on our foreign investments in goods and not in paper.

In order to make a reasonable assumption as to the possibility of collecting the principal on our foreign investments, we can do no better than to take as a basis our net creditor position on international balance as of December 31, 1919, which was about 14 billion dollars. (See Table 1, page 221.) Our net creditor position of December 31, 1930, had grown to 21 billion, by the play of compound interest in eleven years, but it seems fairer to take the earlier and smaller figure. The absurdities of it all are sufficiently impressive, however modified the assumptions.

For easy reckoning, let us assume an annual imports surplus of one billion dollars a year on all items, not including interest. On the basis of this assumption, in the first year 700 million dollars would go to pay interest and dividends on our foreign investments and 300 million to the reduction of the

principal. Without straining after exactness, we may say that by maintaining this billion dollar yearly imports surplus, beginning in 1920, we should, by the end of 25 years, or in 1945, have had our 14-billion-dollar international creditor position about paid off.

This gives us an eminently fair and practical set of assumptions as the basis of a working hypothesis to fit the facts of our situation. The question, Can foreign loans be repaid? then resolves itself, simply, into an inquiry into the possibility of our receiving a yearly imports surplus of a billion dollars, over a 25-year period. Many good people imagine that our debt problem would be solved by an increase in imports. They are mistaken. The size of imports or exports has no importance whatsoever. It is the size of the difference that counts. Imports must exceed exports by one billion dollars. As a bare minimum that requires that imports be at least one billion dollars. To double imports and exports at the same time would only make matters worse, as the balance now stands.

It will be helpful here to recall that during the ten-year period 1921-1930 (normal trade years) our commodity imports averaged about 3,700 million dollars and our commodity exports about 4,500 million each year. It may be added further that during the three years preceding 1930, the average yearly value of our total production of movable goods was about 50 billion dollars. Our hypothetical imports surplus may, therefore, be thought of as a 25 per cent increase in the value of our imports and a 2 per cent increase in the quantity of movable goods thrown on our market, that is, during the first year of the hypothesis.

The entire problem is one of purchasing power and falling prices. The supposition is that, the first year, 700 million dollars of interest and 300 million of principal will be paid in reality or with foreign goods and services. Each year the amount that goes to interest will grow less and the part that goes to principal will grow larger, the total always being one billion dollars, until 1945 when the 14-billion-dollar net credi-

tor position will be paid off. Let us now reduce this hypothesis to a few concrete realities.

Let us first see how it works out in connection with the mechanics of our foreign investments. It will mean that certain foreigners, whom we may call merchant foreigners, must sell enough foreign goods and services to derive from such sales one billion dollars in American currency, over and above whatever quantity of foreign goods it may be necessary to sell in order to secure American money to pay for American exports. (These merchant foreigners may sell these goods to American tourists in Europe.) It also means that certain other foreigners, whom we may call banker foreigners, will buy with foreign money from the merchant foreigners the billion dollars in American money just mentioned. And it will also mean that the banker foreigners will tender the billion dollars in American money, so obtained, to American investors in exchange for 700 million dollars (the first year) of neatly engraved coupons and a few canceled dividend checks. The banker foreigners will also purchase for redemption 300 million (the first year) of ornate foreign bonds.

Now it is important to remember that, so far as the American owners of foreign investments are concerned, there would be absolutely no difference between the payment of foreign debts according to the hypothesis and the manner in which they have been paid up to—well, quite recently, when the German moratorium introduced a new and a more honest method of financing German debt payments. In other words, the American investors are always paid in American dollars and it is no concern of theirs how the foreign bankers procure the dollars. This point, of course, has been abused as an argument in defense of foreign loans, particularly by bankers and officials of the Department of Commerce. The point is correct enough, but proves nothing as to the soundness of foreign loans.

There is, however, one fundamental difference between payment in goods and payment in paper on foreign loans. To this difference attention is now invited. Under the hypothesis of

payment in goods, certain merchant foreigners, it matters not who or how, must sell, *not* a *fixed quantity* of foreign goods, but *whatever quantity, however large*, may be necessary in order to obtain a billion dollars in American money, which can be made available to the banker foreigners for payment to American investors. Under the prevailing practice of paying foreign debts with foreign paper, the quantity of goods on the American market has not been affected by such foreign debt payments.

Great emphasis is laid upon the point that the process of the hypothesis, payment in goods, does not increase by *one cent* the amount of purchasing power, or money, at the command of the American people. In this respect payment in foreign goods does not differ from payment in foreign paper. Payment in goods increases the quantity of goods but leaves unchanged the quantity of money. Payment in paper affects the quantity neither of goods nor of money.

In the opening year, under the hypothesis of payment in goods, assuming the level of prices and the volume of production prevailing in 1929, it would have taken 2 per cent of our domestic production of movable goods to raise a billion dollars. After a few years of dumping each year such a quantity of foreign goods on our market as might be needed to raise a billion dollars, without at the same time increasing the volume of money, it might take 10, 15 or even 20 per cent of our total production to realize the needed billion dollars. We shall return to this point a little further on.

As a matter of precaution, it is said here that the payment in goods of foreign debts, under the hypothesis, would not be the only factor affecting the supply of goods, the quantity of money or the rate of circulation and hence the price level. But this factor would be a constant one for 25 years. It is the steadiness and persistence of the debt-paying factor that counts in the long run.

We are now in a position to explain the events which would follow the receipt of enough foreign goods to buy a billion dollars of American money for American investors in foreign

securities. It is easy to predict the behavior of prices and economic factors under the hypothesis of foreign debt payment in goods for two reasons: First, we are suffering quite similar effects from the paying off of domestic debts. Second, the hypothesis proceeds along the course which England has been navigating to her sorrow since the war. The ensuing theoretical exposition will be confused all the time with what has been happening in England and what is now happening in the United States. The English experience will be drawn on heavily for illustrative material.

But it must be explained, that, badly off as England has been, she had not, up to 1931, gone quite as far as our hypothesis takes us. In 1930, England was receiving only 83 per cent of her foreign income in imports as compared with 54 per cent for 1927-1929 or 0 per cent for the palmy days of 1910-1913, when the full foreign income was being promptly reinvested. In 1931, England probably drank the cup of her foreign investment income to the dregs. Our hypothesis calls for not only taking 100 per cent of the income, but 43 per cent as much again to reduce the principal. Could we do it? The answer is, Look at England!

The British exports surplus, or favorable balance of total trade (goods, services and gold), has declined from a figure of roughly 800 million dollars a year during the four years preceding the war to an annual figure of about 400 million during the seven years 1924 to 1930. It had fallen to 195 million in 1930. In 1931, it was doubtless a minus quantity. Britain is now living on her foreign fat, but it cannot last.

In the purely commodity trade, which leaves out income on investments, as well as from shipping, banking and other services, the British trade balances of interest for present comparison have been as follows: an imports surplus, or so-called unfavorable balance of trade, of 800 million dollars a year during 1910-1913 and of 1,900 million during 1924-1930. The income on British foreign investments was about a billion a year in 1910-1913 and about 1,300 million during the years 1924-1930. New British overseas investments during the years

1910-1913 were about a billion a year, or equal to foreign investment income. During the period 1924-1930 these new foreign investments had fallen to about 600 million a year. Consequently, England has, since the war, been harvesting the delectable fruits of living on about one-half of her foreign income. American free trade liberals would have the United States taste this luxury of cheap foreign goods in payment of our foreign income. It would be great for government clerks.

This book has avoided doctrinary formulations. It would, however, seem permissible to make the following two generalizations about the history of British international and domestic trade behavior: No. 1: The exports surplus (favorable balance) on total trade is a fair index of British prosperity. Britain, thanks to her income from investments, shipping and banking has always had since the Napoleonic Wars, except during brief intervals like the late war, a favorable balance of total trade. No. 2: The imports surplus (unfavorable balance) on commodity trade is a fair index of British misfortune. Britain has always had, since 1844, an unfavorable balance of trade on commodity items. Lately it has grown larger.

Before going further the reader is asked to reflect on the consequences for England of taking half of her foreign income in foreign goods. American free traders have never shown signs of understanding what will now be stated briefly. Before the war the British nullified free trade by foreign loans. A tariff shuts out imports, while foreign loans increase exports. Foreign loans and tariffs produce exactly the same effect on the foreign trade balance. England's loaning days are over. Therefore, her tariff history must begin. An industrial nation cannot practice free trade without large foreign loans, taken out of the standard of living of its workers.[1]

[1] To those who say "What would England have done since the war without her foreign investment income?" this book replies that, had England avoided overspecialization in export industries since 1846 she would not have needed her foreign investment income since 1919. Suppose a man follows an occupation which renders him at thirty-five an invalid for life but leaves him a capital of $10,000, sufficient, however, to support him during only ten of the remaining twenty-five years he has to live. It is obvious that he has made a grave mistake, of which it would be pointless to remark, "How fortunate he

The big point of this reference to current British trade history is this: England's 20 billion dollars of foreign investments have almost wrecked her economy in the past ten years because England has been obliged to take a steadily larger percentage of the foreign income in imports, to the paralyzation of domestic production. England must now adopt a high tariff to save herself from the destructive process of receiving in cheap and satisfactory foreign goods from 50 to 80 per cent of her foreign income. If this fact does not prove that foreign investment income cannot be received except during war times, what could prove it? It also proves the absurdity of large foreign investments in the modern economic world.

Let us now continue with our hypothesis for the receipt by the United States of 700 million dollars in interest and 300 million in principal each year to pay off 14 billion dollars of foreign investments in 25 years, ending in 1945. Let us now develop a little pure theory, merely by way of explaining why what has happened in England had to happen.

The first result of our taking a billion dollar imports surplus would be the initiation of a catastrophic price decline, due to the sheer mechanics of dumping on our market enough foreign goods (2 per cent of our production the first year) to buy a billion dollars in American money each year, without at the same time expanding by one cent the amount of American purchasing power. The price decline would, of course, be gradual, like creeping paralysis. Naturally, uses of credit for investment would progressively diminish as falling prices made production less profitable. The factor of foreign dumping would, therefore, be aided by a contraction of investments, all to reduce the purchasing power of the nation.

As prices fell, it would be necessary for foreigner bankers to force the shipment to us of more foreign goods so as to raise the requisite billion each year. This would create added demand for foreign goods. Foreign prices would rise as our prices fell.

has saved up $10,000!" The simile has even greater point in respect of an economically invalided people whose life is not limited to twenty-five years. There simply can be no justification of an economic policy which makes of a nation or an individual an invalid in the prime of life.

The more foreign goods it took to buy a billion dollars, the merrier foreign industrialists would be. The rise in commodity prices abroad would not be so merry for foreigners who owned bonds, real estate, or whose wages lagged behind the rise in prices. But the woes of these impotent classes would hardly matter.

The corresponding price decline in America would be paradise only for bondholders and for them only until defaults began to eat into their income. Perhaps government clerks and college professors could view the trend with some degree of equanimity. The effects on American industry would be appalling. Foreign goods would be replacing American goods on the markets. New investment expenditures would be declining. The more efficient American producers would, of course, strain their capacity to produce more and survive. This would make matters worse. The country would be moving economically in a vicious circle of wage reductions, price reductions and more misery for everyone. The dynamic impulse for all this starts with the imports surplus the first year amounting to an increase in the quantity of goods by 2 per cent, and no increase in the quantity of money. The resulting miseries all follow automatically from this dynamic impulse. Perhaps other countervailing factors of an inflationary order would make the effects of the imports surplus unfelt the first year or two. The impact would be all the harder when these counteractives were removed.

Now it must not be imagined that the downward trend of prices would be as even as the oncoming of old age, or that it would be unaccompanied by important reactions. There are other factors in the world affecting supply and demand besides the imports surplus. There are such things as crop failures, San Francisco fires, Tokio earthquakes, costly expeditions to carry civilization to the heathen or to protect American or Japanese lives and property among the lesser breeds without the law. But only a first-rate world war could have anything more than a transient effect on our hypothetical factor of the imports sur-

plus. The other factors would pass, the import surplus would be going on for twenty-five years.

It has already been shown that prices had a secular trend downwards over 80 of the 120 years since 1812, and that prices fell from Waterloo to the California Gold Rush. There is no reason why prices in America may not again fall for thirty or forty years until they are half their present average figure. Possibly the prospects are a little brighter for an early war than they were in 1830. But this possibility should not engender any ill-founded hopes among the British or American unemployed.

During the imports surplus era of falling prices, the decline in the standard of living of the whole people would be progressive. It would occur so gradually and be accompanied by so much propaganda, however, as to pass unnoticed. Falling prices must in time reduce the total output by much more than is gained from the cheaper foreign imports. There is, therefore, less to go round. With falling prices only the most efficient producers and the youngest and most active workers can retain employment. The others are eliminated by efficiency and economy. Suicide is the obvious logic of their situation. Of course, the community loses the output of these inefficient losers and is burdened with the cost of their support in idleness.

It is apparent that the exposition of the course of events under the imports surplus hypothesis is getting hopelessly confused with the actual situation in America. This confusion, however, is not one of thought but of the effects of an imports surplus with the effects of the general deflation in the midst of which the industrial nations, headed by the United States, now find themselves. In other words, the imports surplus of our hypothesis would merely constitute an additional factor of deflation, whose potency cannot be easily exaggerated.

Many American liberals are anxious to give us a little taste of it by lowering the tariff. It would, undoubtedly, contribute further to lower prices and to facilitate the receipt in goods of a part of our foreign investment income. But it would only accelerate the speed of our progress towards the day when

American labor will be receiving $2 a day, when millions of comparatively poor people now driving automobiles will be riding in the street cars, and when millions of women now wearing silk stockings will be wearing perfectly good cotton stockings bought in the five-and-ten-cent stores. The American people have two qualities which will stand them in good stead: they are good losers and poor thinkers.

The vested interests of the manufacturers, however, are rather too strong to allow of any tariff revision which would initiate an era of debt repayment through an imports surplus. We shall, therefore, probably go on suffering only the consequences of deflating our internal debt structure and paying interest on an enormous domestically owned debt. This process can go on for fifty years before the debts are paid off. So we have all the effects of an imports surplus from our internal debt mechanisms.

Needless to say, the depressive effects of the imports surplus could be countered by socialistic expenditures of government to create enough purchasing power to absorb the imports surplus plus the full domestic output at the existing level of prices. But it must be quickly added that such a government would never have allowed the export of the people's wealth in the first place. A government of the people and for the people would never have allowed its bankers and merchants to export, on credit, 16 billion dollars of the nation's wealth to help Europeans kill each other. The governments of Washington, the Adams, Jefferson, Monroe or Madison, which were anything but governments by the people, probably would not have allowed such capital exports. It took a twentieth century alliance between the greed of Wall Street bankers, with their national following of profiteering manufacturers and farmers, and the spiritual leadership of misguided liberals of the internationalist persuasion to send to Europe thousands of American soldiers and billions of American dollars never to return.

The answer to the question posed at the beginning of this chapter is that foreign loans cannot be repaid because the rich will not allow the necessary spending to absorb the goods of payment.

CHAPTER XXV

THE PEOPLE VERSUS FOREIGN LOANS

THIS closing chapter of the discussion of foreign investments undertakes in the first part to analyze briefly the effects of capital exports on the standard of living of the people in the lending country, while the lending is in progress. These effects are mainly transmitted through the mechanisms of the money and price system. A reasoned explanation will be given of the obvious fact that a goods-for-paper trade impoverishes the nation that gives goods for paper, though this process favors investors and bankers for the time being. In the conclusion of the chapter, a recapitulation, linked with some further discussion of the present British case in point, will be made of the argument that foreign loans are the genesis of the world's present economic unbalance. It must not be forgotten that foreign loans have always been the keystone of the British free trade, specialization, system.

A part of the case of the people of the lending country against capital exports is the fact that foreign loans operate to keep interest rates high and thus to give capital a larger, and labor a smaller, share of what is produced. The investor's money return on capital invested abroad will be found, over the long run, to be about the same as the return on capital invested at home. During the brief period of frenzied foreign lending, the yield on foreign loans greatly exceeds the domestic return. The borrowers are, of course, paying interest with new loans. In the ensuing cancellation period the yields on domestic and foreign investments tend to equalize.

We know that in 1929 the average return on capital invested in American industry was about 4½ per cent and that in agriculture it was about 4 per cent. Notwithstanding this fact, the average return on some 9 billion dollars of foreign bonds floated in the United States between 1919 and 1930 was 6½

per cent. If people were only rational about these matters, they would see at a glance that foreigners could not pay us this return on billions of borrowed American money. Foreigners are not more efficient than we in the employment of capital. Foreigners have not richer natural resources. And foreigners have no such markets as would allow the earning of these returns in dollars. How ridiculous it is to lend money at 8 per cent to Bolivians, when American railroads cannot possibly earn more than 4 per cent. In 1931 they earned about 2 per cent.

Still, during the borrowing years, foreign investments yielded a high return to American investors. In 1930, the eve of the collapse of world credit, the income on American foreign investments, privately held, worked out to about 5½ per cent. The interest income on our 11.6 billion dollars of foreign assets owned by Uncle Sam was slightly under 1½ per cent. The average return on the combined foreign investments in 1930 worked out to about 3¾ per cent. Now in another five or six years after the 11.6 billion of government loans have been sponged out, and another 5 billion or so of privately owned assets have been canceled, the bankers and economists may be able to show that the average yield on foreign investments at that time works out to 6 per cent or so.

British overseas investments in 1929 included in Sir Robert Kindersley's estimate[1] amounted to about 16.7 billion dollars, yielding in that year an income of about a billion, or 6 per cent. But these figures do not tell the whole story of earnings plowed into capital on corporate investments. The British rarely increase nominal capital out of earnings. In the conclusion of his survey, Sir Robert gives the key to the whole problem when he says, rather disingenuously, that, on account of the depression, the income for 1929 would fall off 350 million dollars in 1931, and when he adds "thus emphasizing the need for building up new investments."

Notwithstanding the constant losses on foreign investments, the institution probably favors the investing class by the simple effects of competition on the domestic interest rate. Here the

[1] *Economic Journal*, September, 1931.

people suffer in two important ways. First, they are forced to give capitalists a larger share of the national income through the maintenance of a higher interest rate, which, in turn, aggravates all the evils attendant on a maldistribution of income. Second, the people suffer the deprivation of the goods produced by them and exported for paper.

For the investor, foreign paper, like a perpetual annuity war bond, means its face value in wealth, as long as credit values are maintained. But for the lending country such paper is exactly like counterfeit money, which might pass undetected in the stream of good money. If foreign debts cannot be paid in goods, foreign paper is a perpetual counterfeit. Just at present we are having a big reduction in the outstanding face value of such counterfeits. But the people will eventually make good foreign losses to investors in the interest rate. The people always pay.

By way of proving the people's case against foreign loans, let us look into the mechanics of the lending process while foreign debts are expanding. Exports of capital increase the quantity of money in circulation but do not increase the supply of goods to be bought with such money, because foreigners get the goods. Goods exported in payment for imports naturally leave just as many goods in the market as are exported. Goods exported for foreign paper mean an increase in wage and other money payments for the production of these exports. This increase in money in circulation is nearly proportionate to the value of the goods exported. There are more wages, more wage earners to spend them, but there are no more goods to be bought with the additional money. Other things being equal, there is a rise in prices. There is more money, more spending, greater velocity of circulation, but no more to be bought. This is the quintessence of prosperity for business men. As Professor Pigou has well pointed out, this business prosperity is enjoyed by business men largely because of a secret mulcting of persons who depend on a fixed income. In time wages, interest and rents slowly rise, but there is an important time lag, which is the business man's fortune. His profit is represented by the dif-

ference between what he receives for goods and what they cost to produce.

During war time labor may obtain superior bargaining power to enable it to offset this disadvantage. In peace time, however, labor cannot escape being mulcted on capital exports. As for investors, the stockholders at once profit. The bondholders in domestic bonds at first lose, but on new purchases of bonds they secure compensation in higher interest rates. It is labor that has no escape from the penalizing effects of capital exports.

A plausible case for capital exports, from the point of view of labor, is developed by arguing that without capital exports there could be no increase in production. This argument merely amounts to saying that American investors can inflate in Australia but not in America, and it denies the feasibility of adequate domestic taxation. The worst defect, perhaps, of this argument, as has already been shown, is that inflation cannot be kept up; all its delights are dearly paid for in the aftermaths.

It is significant to note, in following the line of thought developed in this chapter, that capital exports have always coincided with one or both of the following conditions: (1) A stationary population, like that of France, requiring little new construction; and (2) a lagging standard of living.

Great Britain had a growing population, but from 1895 to 1913 the British real wage was practically stationary, notwithstanding a great increase in productivity per capita. Only in this way could Britain maintain large capital exports, averaging about a billion dollars a year during the last four years, or 1910-1913. In the early days, of course, Britain could both export capital and raise the real wage of labor, due quite simply to British monopolies in manufacturing and shipping. These monopolies explain a rise in the British real wage from 45 to 100 between 1830 and 1895, when it froze until the war. During the war, while Britain was importing capital, labor secured a 15 per cent increase in real wages. Since the war, this increase had been maintained up to 1931, thanks to the dole. These high real wages explain why British post-war exports of capital have

been less than half the annual figure during the four years before the war, though the foreign income has been 20 per cent larger.

The British post-war depression may be correctly interpreted in the following terms: British industrialists, having had since 1895 increasingly higher production costs than Continental competitors, have known no way, as a free trade country, of stimulating production other than war and foreign loans; since the war investors have not been able to make capital exports equal to the pre-war amounts without reducing the real wages of labor to the pre-war level; British labor would not stand for it. As Sir William Beveridge in his book, *Unemployment* (page 369), declares:

"To sum up, post war Britain presents two novel features, unexampled unemployment and a rise of real wages almost equally without precedent."

Sir William Beveridge, in the book just quoted; Professor Siegfried, of Paris, in his essays on the British Crisis; Sir George Paish, in his mid-Victorian economic Pollyanna, and the whole classical school of economists have been unanimous about the solution for the British industrial problem being reduced wages and larger foreign loans. Unfortunately for the successful working of this divinely ordered system, the British laboring man has a vote, which he learned to make use of during the war. The dole defeated foreign loans and free trade, and the British industrialists at last have turned to a tariff, which, however, will not help them.

The new British tariff opens new phases in two old wars. The first war is that between capital and labor in Britain, and the second war is that between British industries and the industries of the world. The fate of the British bankers and industrialists is fairly obvious; that of the British people is more perplexing.

Contrary to popular assertion, a selfish class fight for high wages and not socialism has been the polestar of British labor since the war. The dole is not socialism. Socialism assures work for everybody, even if it be creating things that capitalists do

not approve of. The British Labor Party, when in office, lacked the power to apply socialism. It also lacked leaders with the courage and convictions to advocate constructive socialism. British labor has simply been playing the game of class interest always played by British industry, but, for the first time in labor's history, labor has been holding a few low trumps. Labor has had the "gimmes" for its policy, and capital has been putting up what Dean Donham in his book *Business Adrift* aptly terms "rear guard actions." The contest had developed into a stalemate before the collapse of 1931.

Had a socialist party with men of strong convictions and character, or had a capitalist party with men of keen insight and strong character, taken a few drastic measures against British capital just after the war, English capitalism might have been saved from its present plight. These measures were advocated at the time by many sound thinkers, but received little aggressive support from labor and, of course, encountered positive opposition from capitalists, who thought to save themselves by practicing economy and paying their debts. The only rational policy for England after the war was a quick capital levy to wipe out the entire British domestically owned public debt, followed by a colossal program of industrial rationalization and public works. The classical economists, liberal free traders and international bankers followed their revelation. The French took these capital levy measures, though in the inequitable ways of currency inflation and subsequent devaluation.

If British labor holds its ground, even under Tory tariff protection, British economy must be revolutionized. Investment must be put under social control, but that is state socialism; and before it is seriously undertaken a large part of British capital will have flown. The large estates of the rich will have to be broken up; or transformed from game preserves into fields and gardens to provide food and employment for British labor. It will be the end of Mr. Kipling's England and the beginning of the England of the little Englanders. But, even so, there are too many mouths to feed.

For a long time past it has been apparent that the sun of an

old empire has been setting. But, in 1931, one scanned in vain the horizon for a gleam of the dawn of a new British nation. Imperialism is making its last stand under a socialist deserter of his followers and cause. The ruling classes of England have lots of fight left and still command vast resources. And these will doubtless be expended in a losing fight instead of being devoted to the building of a new England.

The British Labor Party in office has been in the unhappy position of an organization having ideals, entrusted with responsibility, but lacking an adequate program or united leaders. Men like Ramsay MacDonald and Woodrow Wilson always prove pliable in the hands of international bankers during situations of stress, in the management of which the bankers are singularly adept. The weakness of such leaders, when in power, is that they want to be going places and doing things. Obviously, there is, under capitalism, nowhere for an idealist to go in a grand manner except to war. The strength of the bankers is that, with the aid of foreign loans and trade involvements, the priests of Mammon can demand that sacrifices be burned on the altar of patriotism.

Foreign loans and a grinning fate made an American President who "was too proud to fight" lead his people into their most sordid and feckless war. The same explanation fits the facts of Mr. MacDonald's leadership of the Tory Nationalist Government which is setting the new course of British trade policy towards war.

The preceding statement involves no contradiction of what has already been said in defense of tariff protection. Tariff is inevitable for England under any circumstances. As a weapon in the hands of a chauvinistic Tory Government, attempting to save a lost industrial situation as well as imperial face, tariff policies can only accelerate the processes leading to war. Only the orderly liquidation of the British imperial establishment and the reconstruction of England into a more self-sustaining economic unit can make it possible for Britain to keep the peace over any considerable future. In such a program tariff would be a necessary instrument of policy. But tariff is now being

adopted with no such end in view. Tariff is the last resort of a desperate British industrial and money oligarchy with its back against the wall. A Russian czarism similarly had its back against the wall from its defeat in the Russo-Japanese War in 1904 until 1914. "No surrender, They who have no retreat must conquer or die." Free trade and foreign loans started England on this course nearly a hundred years ago.

The effects of capital exports on the welfare of the people can be interpreted only in the light of the World War and its politico-economic sequels, of which the British financial and political crises of 1931 are the latest and most significant phases. Capital exports, in lieu of a balanced foreign trade, are one of the principal dynamic factors of an economic character causing the World War, enlarging the scope of its horrors by mobilizing through greed and credit the tremendous productive powers of America to serve the ends of European destruction and slaughter, and aggravating the duration of the financial sequels of the five-year carnage. Capital exports and their concomitants are the dynamic factors in the world depression. They are, of course, synonymous with foreign debts, unbalanced trade and price instability.

Mr. MacDonald's present task has received attention in this chapter because the crisis with which he has become associated is the opening of the final act in the drama of more than a century of capital exports. England is what she is and where she is today because her economic rulers chose to export the nation's wealth instead of developing a well-balanced national economy. The crisis of 1914 was nothing as compared with that of 1931. For situations like that of 1914 the British Navy has always been ready, aye ready. British finance and industry, however, were not equal to 1931. The successors of Drake and Nelson have never failed England. The successors of Shylock have let her down.

The American banking allies of the British were able during the war to peg the pound around $4.76 but they could not save it in September, 1931. The reason was that the American people cannot be deluded twice in the same way in one genera-

CONCLUSION

SPIRITUAL LEADERSHIP. ADEQUATE ACTIVITY. TAXATION OR INFLATION

THIS book has pointed out a number of things wrong with capitalism. In so doing, it has not advanced the thought that the survival of capitalism depends on the correction of certain institutional defects. Capitalism is a way of doing things, largely with a productive equipment which is not the peculiar property of the private enterprise system, as some people erroneously suppose. If the capitalistic pattern of ways is to endure, it must, it would seem, develop two qualities, of which it has shown a great lack during the post-war period. The first quality is a compatibility with adequate spiritual leadership for the people. The second quality is a susceptibility of evolution towards better adaptation to the needs of the race for both biological survival and spiritual growth.

With regard to the first quality, it would appear towards the close of 1931 that war offers the one and only prospect for the emergence of adequate spiritual leaders. The American people have, undoubtedly, as fine material for leadership as any people ever possessed, but it is unthinkable that a mildly humane leader of the type of a Jackson, a Lincoln, a Cleveland, or a Roosevelt could possibly emerge in the present business pattern of our civilization. To occupy positions of influence or responsibility in the America of today, a man must have the endorsement of big business, which means that he may not have the soul of a leader. The American people demand this quite as much as business. The nation is as deeply imbued with the business faith as any people ever was with a state religion. The agencies of public opinion formation are under commercial control. Effective free speech since 1915 would have corrected or greatly minimized the evils discussed in this book. The war

to make the world safe for democracy gave free speech in America an indecent burial. The people have since been betrayed by their spiritual leaders. To the press and the university it is perhaps not appropriate to address the reproach of a betrayal, since they have been loyal to those by whom they have been bought and paid for. The churches, as a spiritual force, of course, have been dying for many years. The people will suffer and complain under their business leaders, but follow them they must, to the bitter end, for the people have no other leaders. Nor have they any other faith.

This leadership must with equal blindness march fatally towards war and its logical culmination, the exact character of which it would be idle to predict. It seems safe to hazard the guess that the next war will usher in a long era of restricted freedom for the expansion of human personality. If the suffering of the coming war is sufficiently long and terrible, as it gives encouraging promise of being,—short and easy wars are not worth while,—it is certain that out of it will be born a new social consciousness calling for a fresh leadership. To expect such leadership to arise under less dynamic circumstances seems vain. Great ideals are born only of great travail and pain.

With regard to the evolution of capitalism towards a better adaptation to human needs for biological survival and spiritual growth, it is evident that no progress has been made by business since the seventeenth century. Extraordinary advances have been made in machinery and technique, many of which have redounded to human welfare. Business, however, has learned nothing.

No natural event occurred between November 11, 1918, and October 11, 1929, to bring on the world crisis. There was no force, outside of business behavior, at work to slow down production or consumption. On the contrary, every development in science, the industrial arts and public taste favored a rising tempo of economic activity and social advance. The war losses cannot be blamed. These losses were quickly replaced, to the prosperity of all engaged in the task.

This book contends that the present crisis was and remains

100 per cent a group of business and credit phenomena, thus proving conclusively that business men have learned nothing and that business has made no progress. Every element of the present depression was deliberately put together by business men acting in accordance with the consensus of the best prevailing opinion which was never better informed or more effective.

American business leadership has most responsibility for the world disaster merely because we have had most of the world's gold and financial power, largely as a result of our war profiteering. In America, business leadership cannot complain of obstruction or lack of cooperation, cooperation being a term applied in late years to the betrayal of public to private interest. Business has had its best men at bat both in Wall Street and in Washington.

Not only have these best men brought on the depression, but, as it deepened and thickened in 1931, their best thought produced nothing better than unsound credit companies to sustain insolvent banks and begging campaigns to keep the unemployed from starving. Business leadership is inadequate in itself and inhibitory of other types of adequate social leadership. Business has not progressed towards the land of the heart's desire. Business is business.

The point of view of this book is not unlike that which a citizen of Rome might have taken a century or so before the fall of the empire. He would not have regretted the doom of prevailing leaders, but he would have been saddened by the contemplation of the loss of many of the values of Roman civilization. It is not to be inferred from the use of this simile that the decline and fall of capitalism is expected to plunge the world into a period corresponding to the Dark Ages which succeeded the collapse of Roman civilization. Should capitalism fall, its successor system or systems will conserve the full technical heritage of the race. Those for whom civilization means modern plumbing and radio need have no worry. To those for whom civilization means a large measure of opportunity for self-realization, the opening of an era of economic

dictatorships will be tantamount to the revival of the Dark Ages.

This chapter aims to leave in sharp focus the following conclusions: First, the fundamental need is for spiritual leadership and not technical services. Second, such leadership is effectively inhibited by the dominance of a business culture. Third, the main contribution of spiritual leadership, in so far as the economic concerns of the people are involved, must be that of generating sufficient activity to provide satisfactory employment and living conditions for the whole people. Fourth, the means through which adequate activity can be maintained, in the senility of capitalism, must be systematic confiscation by taxation rather than haphazard confiscation by inflationary uses of credit.

The taxation methods of insuring adequate activity will now be discussed. Inflation makes capitalists pay with great eagerness in the beginning through the process of new investment. Then there must come about in time a curtailment of consumption and production as a result of the attempts to repay the capitalists, or else there eventuates confiscation from the capitalists by the processes of business losses and defaults. Honest confiscation by taxation, on the other hand, never imposes the necessity for any curtailment of output. The limits of output are capacity and resources.

It is easy to create debts that cannot be paid. It is impossible to confiscate more than is produced. The confiscator may demand more than can be produced, but he cannot take more. Production will perform quite as well for government—be it that of the Pharaohs, of Emperor William in 1915 or of Mr. Stalin in 1931—as it will for private spenders. If adequate spending be assured, everything else will take care of itself. The expression "adequate spending," of course, needs qualification. For instance, adequate spending avoids spending too much on factories for which there is no need and too little on factories and plants for which there is need. Consumption and not investment greed must rule the use of savings in any rational economy. If consumption is properly planned and

provided for, production will need no planning, except in abnormal seasons like war.

An essential quality of adequate spending must be its amount. For purposes of easy reckoning, it may be assumed that an increase of total expenditures by the American people to aggregate, roughly, 10 billion dollars a year would initiate an adequate solution of the present problem of unemployment and the depression. Perhaps the figure may be a little low, but it will serve as a starter. Some 70 per cent of this increase in total spending may be assumed to go in wages, while the remainder would go in rent, royalties, interest, profits or dividends. An additional 7,000 million dollars paid in wages would come near to $100 a month for 6 million of the now unemployed. The present cost of government in the United States, in round figures, is about 12 billion dollars a year. An 85 per cent increase in taxation and, hence, in public expenditures would, therefore, go quite far towards solving the unemployment problem as well as ending the depression in America.[1]

If the size of these amounts shocks the reader, he is reminded that it is not expected that the suggestion will receive serious consideration or that anything is going to be done about unemployment. The point to advancing an adequate solution is to show that the problem is as simple as that of

[1] The taxpayer should be reassured that the order of events in the recommended ten billion dollar budget increase would not be, first, taxation, and, second, spending. That, the already overburdened taxpayer could with difficulty bear. Quite the reverse. The sequence would be the spending of the additional ten billion dollars followed by its recovery through taxation, largely from those who would have profited from the effects of such spending. It would seem preferable for the state to effect the spending by a direct emission of paper money as needed rather than by an indirect or secondary issue of paper money against successive creations of interest bearing public debt. The state should avoid even short term borrowing at interest to cover the abrupt expansion of public expenditures. It would then transpire that, while production, consumption and fresh investment would be greatly accelerated by the enlarged volume of government demand, the long run stability of prices would not have to suffer more than an initial readjustment upwards of prices to a higher level of total demand. After this initial price readjustment had taken place, the state would maintain relative price stability by the simple expedient of a somewhat elastic spending policy calculated to keep the productive factors of the nation fully and constantly employed.

keeping a reservoir full of water. You just keep on pouring water in as fast as it flows out. Determining the right quantity in advance needs no two-year study of facts.

It may happen, as prices fall and wages go down to half their present figure, that a certain number of the now unemployed may find jobs at lower wages. Still it is fairly certain that we shall have several millions of unemployed indefinitely. And with this state of affairs we shall have a steadily falling standard of living for the American people.

But let us continue with the theoretical discussion of the tax solution. It may be objected that, were the state to confiscate and spend 10 billion dollars a year more than it has been doing, there would not result a corresponding increase in the total volume of expenditure, since many taxpayers would reduce their personal expenditures, fresh investments and even their productive activities. A brief answer to these objections follows.

In the first place, as a matter of history, the records of war-time taxation and consumption of luxuries show conclusively that personal expenditures are not necessarily reduced by high taxation. Rich taxpayers may lay up private yachts, but longshoremen blossom out in silk shirts.

In the second place, government demand for new classes of goods at remunerative prices creates a powerful incentive to new investment in plant to furnish these goods. It is grotesque to talk of wealthy people reducing their investments when prices are rising and demand is firm. Obviously, if the government's demand dominated the market and called only for certain types of goods, such as munitions, fresh investment in other lines of production would languish. Total physical production would, however, expand. Peace-time government spending would, of course, not be one-sided as war spending, nor would it constitute such a large percentage of total consumption—not even with a 100 per cent increase in present budgets.

A 10-billion-dollar annual increase in taxation would not, therefore, prove as disastrous to capitalists as the figures would, at first glance, suggest.

In the first place, there would be additional income received by capitalists in the form of larger dividends, commercial profits, rent payments and interest as a result of public spending. In the second place, there would be a mild and brief rise in prices, due to the additional spending. This price increase would enlarge the money amount of the taxpayer's wealth and income. In the third place, there would be an increase in production by reason of the full employment of 6,000,000 now idle men. The rise in prices would, therefore, not be as great in commodities, or in the cost of living, as it would be in security and land values. The rise in prices would, in other words, not be purely inflationary. It would coincide with an almost equivalent increase in physical production. The nation would have 10 billion dollars more to spend, but it would produce practically 10 billion more.

These explanations, it will be understood, are offered not with a view to suggesting that the tax levy of 10 billion dollars, properly distributed, would leave capitalists none the poorer. The idea is simply that the impoverishing effects on the rich of the first tax levies would not be ultimately confiscatory of the full amounts taken. If enough were taken to put the unemployed all to work, and not merely to keep them from starving in idleness, the rich would get back a great deal. Just how much, no attempt is made to estimate, because it would depend on innumerable, unpredictable factors.

The initial rise in security and land values might, at first, well encourage the illusion that the rich were being fully reimbursed their tax contribution. This rise in property values, however, would not continue. Once the level of full production and employment was reached, thanks to confiscatory levies on the spending power of the rich, taxation would keep consumption and production at that level. There would then be no further rise in commodity prices, and the rise in security values and land values should be no greater over a period of years than some 3 or 4 per cent a year, corresponding roughly to the growth in the total wealth of the country.

Let us now develop some advantages of this impoverishment for the decently-minded rich.

In the first place, capitalists, as a whole, would be assured a much steadier flow of income than at present. Over the long run, they would not get as large a return on invested capital or as big a slice of the national income as formerly. They would, however, be assured a steadier flow of income than at present. Government spending would iron out to a large extent the present curves in the business cycle. In prosperous years, like 1925-1929, when Mr. Mellon was gaining the reputation of the greatest Secretary of the Treasury since Hamilton, a statesmanlike, social administration of public finances would have followed different policies. It would not have lowered income taxes to release excessive investment funds for unbalanced industrial expansion, stock speculation and unwise foreign investments. It would have reduced the public debt more rapidly and built public works. In this way depressions would be practically eliminated. The return on saved capital would be less, but it would be easier to select a safe investment and a steady income.

In the second place, a slower rate of accumulation on capital would be no manifest hardship if the incidence of the curtailment of net return were evenly distributed. Wealth and income are relative advantages. Under heavy taxation, the taxpayer would gain on wealthier taxpayers and be gained upon by poorer income receivers. The rich would still be at the top of the pile, only the pile would be lower though no smaller.

It is appropriate to make the point that the principal compensations of wealth are prestige and power, not the size of fortune that can be accumulated and handed on to heirs or charities. These compensations are equally enjoyable under high as under low taxes. The richest citizen in Bingville with an income of $25,000 a year may be a bigger frog in his pond than a citizen in New York with an income of a million a year.

In the final analysis, the problem of equalization by taxation, or the solution of unemployment and insufficient economic activity by levies on wealth, presents the following choice to the capitalist: maximum accumulation and freedom

of action or maximum social welfare and security both of a steady return and of future tranquillity in the enjoyment of the rights of property.

There is no hocus-pocus alternative. Somebody always pays. Under all credit schemes, an increase in production and consumption is eventually paid for by a corresponding reduction. Sometimes the creditor pays in defaults and losses. More often the debtor pays in a lower standard of living after the inflation is over. Debts are paid *by* people *with* things.

The whole problem of unemployment and Mr. Hoover's fight to save the rich from high taxation turns on the question, to confiscate or not to confiscate wealth. Mr. Hoover, the rich and, probably, a majority of poor American taxpayers are prepared to fight out the unemployment battle on the present bread line until the next war. In the meantime, they will toss pennies to the unemployed, and millions of people of moderate income, who extol Mr. Hoover's economy policies, will be supporting relatives and friends in idleness, for whom the government might create work. It is notorious today that the bulk of the funds raised for the unemployed by committees throughout the country is being collected from relatively poor employees by methods which approach coercion. The rich prefer to do the levying for the unemployed to having it done by the state, as they know that they could not easily dodge progressive taxes. The rich are now levying upon their poor employees to support the unemployed, instead of being levied upon equitably by the state either to support the unemployed at a starvation level, as under the British dole, or, better still, as this book advocates, to pay the unemployed for useful work. We have the dole in America, only the rich assess it on the community of poorer people by begging campaigns.

The choice between a solution of unemployment by a permanent government spending program and the present policy of watchful waiting makes war our only economic alternative. It is of no small importance to the peace of the world that a good-sized war in 1932 would relieve capitalists and workers the world over. It would instantly furnish employment to mil-

lions of unemployed and large profits to business men. And it would assure Mr. Hoover another four years of prosperity, exactly as the World War saved Mr. Wilson from defeat in 1916.

The American people have now admitted that they are going to do nothing about unemployment. War, therefore, is the inevitable solution. It will impose itself by the force of economic and political events brought to bear on statesmen who do not know what it is all about. The more our statesmen talk peace, and the greater their sincerity of belief in what they say, the more inevitable becomes the war issue.

Statesmen cannot avoid war in certain situations. Neither do they deliberately provoke wars. They merely build up situations which make war inevitable. Keeping six to eight million men unemployed in America for several years is the best known way to prepare for war. The day a war starts somewhere in the world, millions of unemployed, farmers and industrialists, will heave a grateful sigh of relief. As American business picks up, American idealism will get acquainted with the moral issues of the new Armageddon, and history will repeat itself.

Over-simplification is a charge to which this book is vulnerable and nowhere more than in this chapter. There is no doubt about the complexity of the economic machine, but this complexity does not prove the difficulty of achieving with the machine any desired economic result. When this nation goes to war, it does not flounder for two years finding facts. It begins at once finding fighting men, munitions and supplies. The facts are found after the war is over. For two years Mr. Hoover and big business have found facts and not jobs. Mountains have labored and brought forth the mouse of plain, old-fashioned begging for the unemployed.

The explanation is purely spiritual, and in no way technical. There was a will to find war supplies in 1917 and there has been no will in Washington, Wall Street or Main Street to do anything for the unemployed except to hope that something would turn up. The obvious lesson of it all is that the will to end unemployment cannot be instilled in the hearts of the

people by an engineer President, bankers or fact finders. We return to the point from which this book began. The danger for capitalism is the lack of spiritual leaders for the people.

The great evil done by the experts of the social sciences in this country has been that of emphasizing instruments and technique. The arts of satisfying one's economic wants or of expressing one's self in the creation of beauty are, in all essential respects, phenomena of the emotions and not of instruments or technique.

The illusion of objectivity is cherished by a large school of pedants and technical consultants in the so-called social sciences. Most of these unhappy individuals are in much the same situation as musicians who would like to be discoursing Beethoven in a symphony orchestra, but who, having families to support and being mediocre artists, must play jazz in night clubs for a living.

Another mischief wrought by the objectivity cult is that of deluding people into the belief that human progress is the march of a team of technical experts driven by human greed and cunning. The evidence shows that the only useful contribution scholarship has ever made to the ultimate solution of social problems has been spiritual rather than technical.

States of feeling, not knowledge of facts or technique, determine choices, generate activity and, in short, shape human destiny, in economics quite as much as in love or in war. Value and demand, the two most fundamental economic concepts, are the products of the emotions. If the capitalistic machine, as it is now functioning, inhibits such leadership as is essential to the creation of the right states of feeling for a satisfactory quantity and quality of activity for the biological survival and the spiritual growth of the human race, it would seem that the machine is doomed. One thing is certain: man will go on living and working. Possibly frequent wars, which will bring into play strong spiritual leadership, will continue to provide the requisite solutions at appropriate intervals. But, then, can capitalism survive many modern wars? Russia suggests grave doubt.

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