An Early Harvard *Memorandum* on anti-Depression Policies.[1]

Introductory Note

by

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The *Memorandum*’s Authors and Their Message

The *Memorandum* which this note introduces was completed by three young members of the Harvard economics department sometime in January 1932 Two of them, Lauchlin Currie and Harry Dexter White were soon to play key roles on the American, indeed the world-wide, policy scene. Both of them would go to Washington in 1934 as founding members of Jacob Viner’s “Freshman Brains Trust”. In due course, first at the Federal Reserve Board, and later at the Treasury and the White House, Currie would become a highly visible and leading advocate of expansionary fiscal policy, while White, at the Treasury, was to be a co-architect, with Keynes, of the Bretton Woods system. Both would fall victim to anti-communist witch-hunts in the late 1940s, in White’s case perhaps at the cost of his life, since he died of a heart attack in 1948 three days after a strenuous hearing before the House Committee on Unamerican Activities (HUAC). The third author, P. T. Ellsworth, later a Professor of Economics at the University of Wisconsin, is perhaps best remembered nowadays as the author of a leading textbook in International Economics, though it is worth noting that he was also a very early (late 1936) but hitherto unrecognised discoverer of what came to be called the IS - LM model as a means of elucidating issues raised by Keynes’ *General Theory.*[2]

It is not known how widely this *Memorandum* was circulated, but the fact that it is a piece of policy advocacy, combined with its relatively polished style, makes it inconceivable that it was meant for the eyes and files of its authors alone. As readers will see, it sketches out an explanation of the then rapidly developing Great Contraction, as well as a comprehensive and radical policy programme for dealing with it. In keeping with its authors’ explanation of the Contraction as a consequence of a collapsing money supply, the main domestic components of that programme were to be vigorously expansionary open-market operations and substantial deficit spending that, particularly in its early stages, was to be financed by money creation; its international dimension involved a return to free trade and serious efforts to resolve the problems of international

[2]The standard source of information on Currie’s life is Sandilands (1990); on White, see David Rees (1973). We are unaware of any biography of Ellsworth. His (1936) exposition of a version of the IS-LM model seems to be the second to have appeared (after that of W. B. Reddaway 1936) and antedates J. R. Hicks’ (1937) exposition of the system. Warren Young (1987) does not refer to it in his now standard history of the “IS - LM ization” of Keynesian economics.

indebtedness that had originated in the Great War and in the Treaty of Versailles which had brought it to an uneasy end in 1919.

The *Memorandum*'s Significance

The existence of this *Memorandum* has recently been noted in one or two publications, but apart from a brief discussion in Sandilands (2000) its significance has not been adequately appreciated. It is, self-evidently, a coherent work of high intellectual quality, and provides important documentary evidence about the state of macroeconomic thought in general in an important intellectual centre, namely Harvard, in the early years of the depression, before the New Deal and before the importation of the theoretical ideas of Keynes' *General Theory* (1936). And it also provides considerable insight into the early intellectual development of Currie and White, both of whom had great influence on the course of US domestic and international economic policy in the years of the Roosevelt Administration. The importance of a document in which these two had a hand, and which deals extensively with domestic macroeconomic policy and international economic relations is surely self evident. It merits the attention of any historian of inter-war economic thought for this reason alone. But the *Memorandum* is interesting for other reasons too.

To begin with, it constitutes compelling evidence, over and above that already available, against the still widely held view that, before 1936, the economics department at Harvard University was sunk deep in pessimistic intellectual mediocrity whose chief characteristic was uncomprehending hostility to the New Deal. This state of affairs is often contrasted with an allegedly vibrant "Chicago Tradition" of policy optimism which would render that Department immune to the attractions of the Keynesian economics which came to dominate Harvard from the late 1930s onwards. There is certainly much pessimism and mediocrity to be found in Harvard writings early in the decade, but this *Memorandum* demonstrates that the overall picture was altogether more complicated, not to say better balanced than that. Anyone who reads it, and then to turns to Chicago writings of the period will find it hard to discern much of importance that is unique to the latter[3]

[3]The first mention of this Chicago Tradition seems to have been in Milton Friedman (1956), and its nature and claim to uniqueness were subsequently discussed by, among others, Don Patinkin (1969, 1973) Thomas Humphrey (1971), and Friedman (1974). The links, or absence thereof, of this tradition to ideas current at Harvard are debated by Laidler (1993, 1998) and George Tavlas (1997,

Second, it is already widely acknowledged that the work of one of this *Memorandum*'s authors, Lauchlin Currie, ran counter to generally held views of Harvard's output at this time. His published work before 1935, however, dealt exclusively with questions of monetary policy, which he not only blamed for the onset of the depression in 1929-30, but also for it persistence and depth thereafter[4]. Though Currie's systematic and visible advocacy of fiscal policy later in the decade is known to have had its origins in material that he taught at Harvard in the early '30s, this *Memorandum* provides by far the earliest available written account of this element in his thought.[5] Its multiple authorship, furthermore, is conclusive evidence that Currie was by no means the lone wolf that he is sometimes portrayed as having been in the Harvard department of the early 1930s. It is an important document in his *oeuvre* for both of these reasons

Finally, there are strong similarities between the programme set out in this *Memorandum* and the one embodied in the "Recommendations. . .", sent to President Hoover over the signatures of 24 economists who participated in the conference on "Gold and Monetary Stabilization" held under the auspices of the Norman Wait Harris Foundation at the University of Chicago on January 27-31, 1932, and published in its proceedings (Wright 1932, pp. 161-163). This conference took place at the end of the very month in which this *Memorandum* was completed. Currie, Ellsworth and White are more enthusiastic advocates of expansionary fiscal policy than the signatories of the above-mentioned "Recommendations. . .", but the support for open market operations and international co-operation on issues of debt and tariff reduction to be found in the two documents is equally strong.

Given the venue of the Harris Foundation conference, and the fact that no fewer than 12 of the signatories of its "Recommendations" occupied posts at the University of Chicago, it has long been cited as one the seminal documents of the above-mentioned Chicago Tradition in monetary analysis.[6] But as one of us (Laidler 1993) has earlier noted, one of the non-Chicago economists involved in drafting them was John H. Williams of Harvard, and he was selected by those involved to write a paper (Williams 1932) for the conference proceedings explaining its "Recommendations.

1998a). Tavlas (1998b) later restates the view that the Chicago Tradition was unique.
[4]Recognition of Currie's work begins with Karl Brunner (1968) and Humphrey (1971)
[5]On this, see Currie (1978) and Sandilands (1990)
[6]Friedman (1974) makes much of the 1932 Harris Foundation conference as an example of the Chicago Tradition, and in so doing he draws on the work of J. Ronnie Davis (1968) who also discussed it extensively. See also Davis (1971).

. .". The record of his oral contributions to the Harris Foundation conference suggests that he was probably familiar with this *Memorandum,* and certainly well acquainted with some of the ideas emphasised in it.[7] The existence of a Chicago tradition in the analysis on the Great Depression is in no way called into question by the *Memorandum's* existence. It does, however, decisively undermine the strong claims that have sometimes been made about that tradition's uniqueness, and it also provides circumstantial evidence of a significant Harvard influence on one of its earliest documents.

We shall now elaborate on these matters in turn.

Harvard Economists and the Depression

The best known product of the Harvard Economics Department dealing with the early 1930s is a collection of essays entitled *The Economics of the Recovery Program* (D. V. Brown et al., 1934), which the department's historian Edward Mason (1982) has tactfully characterised as "not very distinguished". We prefer to stand by the verdict of Laidler (1993, p. 1078) that most of them "verge on the incoherent and do no credit to their distinguished authors". The only coherent contribution to this 1934 collection, that of Joseph Schumpeter, advanced an essentially "Austrian" interpretation of the depression. Schumpeter located its causes in a bout of over-investment which had collapsed in 1929, and argued forcefully that attempts at a cure by monetary or fiscal expansion would serve only to prolong the slump. This was also the view of another member of the Harvard department, albeit a visitor from Vienna at this time, Gottfried von Haberler, who gave it a thorough airing in a paper (Haberler 1932) presented to the very Harris Foundation conference that produced the "Recommendations. . ." referred to earlier, which Haberler did not of course sign. There is, then, no question that Harvard's reputation for mediocrity and policy pessimism at this time is founded in fact. But this has never been the whole story about Harvard in the early 1930s.

In the 1920s, its Economics department had been an important centre for the development of monetary economics, largely under the leadership of Allyn A.Young, who had temporarily left it in 1927 to take up an appointment at the London School of Economics, from which he had expected to return in 1930. As Perry Mehrling (1997) has argued, Young's work in this area sought a middle

[7]A complete transcript of the conference's deliberations (Norman Wait Harris Foundation, 1932) is to be found in the Regenstein Library at the University of Chicago

ground between the quantity theory of Irving Fisher and the real-bills approach of Henry Parker Willis which dominated thinking at the Federal Reserve Board in the 1920s and early 30s; and it had informed his efforts as an advisor to Benjamin Strong at the Federal Reserve Bank of New York.[8] Young was a great admirer of, and was in turn admired by, Ralph Hawtrey, whose only academic appointment, as a visitor to Harvard in 1928-29, he was instrumental in arranging.[9] In common with Hawtrey, Young was a supporter of the gold standard and an advocate of discretionary monetary policy aimed at ironing out the cycle, but unlike Hawtrey, he was an advocate of public works expenditure as a tool of stabilisation policy in its own right. Young died of influenza in the winter of 1929, leaving a vacuum in the field of what we would now call macroeconomics among the senior ranks at Harvard that Joseph Schumpeter was soon to fill.

Currie, one of the three authors of the *Memorandum* that is the focus of this note, was something of a protege of Young, and had been Hawtrey's assistant during his year at Harvard. His Ph.D. thesis (Currie 1931), completed under Williams' supervision and submitted in January 1931, blended Hawtrey's monetary cycle theory with Young's empirical approach to the analysis of the United States monetary system, and offered (among other things) a quantity theory based explanation of the downturn that began in 1929, a critique of the Federal Reserve system's passive response to it, and the suggestion that a more vigorously expansionary monetary policy would have been appropriate[10]. And Currie's *Supply and Control of Money in the United States* (1934), dedicated to Young's memory, further develops this theme, and is particularly notable for expounding the thesis that, far from having engaged in expansionary policy as it claimed at the time, the Federal Reserve system had remained largely passive as the depression gathered momentum into 1932-33. He can, then, reasonably be regarded as having largely anticipated the monetary explanation of the great contraction that was later developed by Friedman and Anna J. Schwartz

[8]In addition to Mehrling's study of Young, the reader's attention is also drawn to Mehrling and Sandilands' "Editors' Preface" to their (1999) collection of work by him, much of it hitherto unknown, as well as to Charles Blitch's (1995) biography.
[9]For Young on Hawtrey, see for example his (1924) review of *Currency and Credit,* and for Hawtrey on Young, his (1927) review of *Economic Problems New and Old* .
[10]An interesting feature of Currie's thesis is that though the original (1931) version of it contains an extensive discussion of Hawtrey's work, this material was deleted from the later draft that was submitted for the Wells Prize competition at Harvard. See Laidler (1999, p. 234, fn.25). We speculate, without any direct evidence, that he may have done this because Haberler, one of the judges for the competition that year, was known to be hostile to Hawtrey, having, for example, explicitly and sharply criticized him in (1932). Whatever the reason, however, the modification was to no avail. The prize that year was awarded to White. See Sandilands (1990, p. 23)

(1963). Only in his sometimes ambiguous discussions of the build-up of excess reserves in the banking system during 1932-33 does his analysis differ from theirs.[11]

Particularly important in the context of the following *Memorandum*, there already exists evidence that Currie's work along these lines was not an isolated endeavour. Specifically, when Erik Lundberg spent time at Harvard in 1933 he found the department an altogether more lively centre of debate than Chicago had been in the previous year, and he described its environment in the following terms.

> "Schumpeter had gathered around him a group of young economists, all working with modern monetary theories. During most of the summer I had discussions with some of them, especially on monetary questions concerning the business cycle. In Washington, and also to a large extent in New York, I had repeatedly heard of the tremendous inflation during the years leading up to 1929. At Harvard, reputed for its conservatism, I now learned that there had been no inflation, but rather the contrary. Professor [sic] Currie was the most eager advocate of this theory. . . .; Currie was not alone in holding this opinion. He, as well as the others who held this belief at Harvard were good economists, as were the people with the opposite view in New York and Washington." (Lundberg 1934, p.62)[12]

Evidently Currie was no lone wolf at Harvard in the early 1930s, as Tavlas (1997) characterizes him, but nor was he a professor as Lundberg had it; he was an untenured instructor. It would, however, be a mistake to think that divisions of opinion about macroeconomic questions at Harvard lay solely along lines demarcated by age and rank, with mediocrity and pessimism being concentrated among the department's "establishment". Though they would in due course become members of that establishment, some contributors to the *Economics of the Recovery Program* were

[11] Brunner (1968) and Humphrey (1971) were the first to recognize the significance of Currie's contribution here. Frank Steindl (1995 ch.4) has defended the uniqueness of Friedman and Schwartz's interpretation, though conceding that Currie came closer to anticipating it than any other writer in the 1930s, largely on the basis of his reading of Currie's discussions of excess reserves.

[12] In this passage, the word "inflation" should be read, in accordance with the common usage of the time, as referring to the expansion of money and credit, rather than to a rise in the price level. The view that the Depression was the inevitable consequence of a previous overexpansion of credit in the 1920s was held in common both by Austrian analysts such as Haberler, but also by advocates of the Real Bills Doctrine such as Henry Parker Willis. On this, see Laidler (1999, pp. 214-7). Currie and his co-authors of the following *Memorandum* clearly blamed it on the contraction of the money supply which began in a mild way in 1928 but quickly gathered momentum after October 1929.

young and untenured in 1934 (e.g. Wassily Leontief, Edward Chamberlin, Seymour Harris). Also, as we have already noted, at least one member of that establishment, John H. Williams was sufficiently sympathetic to proposals like those of Currie and his associates to have been involved in drafting the Harris Conference "Recommendations. . ." that so closely resemble them. And in the background here was surely the shade of Young, who had advocated monetary and fiscal stabilisation policies in the 1920s, and had also, incidentally, written extensively on the monetary problems created by the international indebtedness left over from World War 1 and the Versailles Peace Conference, which he had attended as a senior adviser to the American delegation.[13]

What seems to have happened at Harvard in the 1930s is that, among the younger members of the Department, and Williams' sympathy notwithstanding, those whose macroeconomic views were hostile to the New Deal won promotion and stayed, while those who took the more radical and intellectually coherent position epitomised by the attached *Memorandum*, either left or were eased out. By 1936, therefore, when "Keynes came to America" with a new crop of graduate students who had studied with him at Cambridge and then migrated to Harvard, the department was perhaps a less interesting and lively place than it had been only a few years earlier.[14] But it had indeed only recently been the centre of much debate, as Lundberg has told us, and what we would now call "proto-Keynesian" ideas had been well represented there as the following *Memorandum* conclusively demonstrates.

Currie's Economics

Currie was among those eased out of Harvard. As we have already noted, he was, along with White, a founding member of Jacob Viner's so-called "Freshman Brains Trust" in Washington. This appointment, which began in June 1934 was supposed to be for a matter of months, and when he was invited to extend it into the autumn of that year, Harvard refused to grant him further leave, in effect forcing his resignation (see Sandilands 1990, pp. 56-57).

[13]We nevertheless hesitate to enroll Young as a posthumous supporter of Currie and his colleagues. During his life, Young attached great importance to the gold standard, and may well have hesitated to support wholeheartedly measures that might have put US adherence to it at risk. But that his work profoundly influenced Currie is beyond question.
[14]Colander and Landreth (1996) contains a series of conversations with some of the economists involved in this later episode.

By his own (1978) account, Currie had been in difficulty with some of his senior colleagues for advocating unbalanced budgets as a means of fighting the depression long before 1934. Though no-one, to the best of our knowledge, has ever questioned this particular claim, it does at first sight sit oddly with the so-far available published record of his work at Harvard which deals solely with monetary policy.[15] At the very least, it leaves open the question of how his analysis of fiscal policy at that time might have fitted in with his work on monetary questions. One commentator, Tavlas (1997, p. 170), has suggested, largely on the basis of Currie's (1978) account, that his policy stance rested on a belief in "the inefficacy of open market operations and the need for budget deficits." Currie's published work, not least (1934) shows that he did indeed think that the open market operations carried out by the Fed. early in the depression had been ineffective, not, however, because he believed that such measures were inherently weak, but rather because they had not, in this instance, been carried out on a sufficiently large scale. As Currie argued (cf. 1934a, pp.146 - 47), in 1932 in particular, gold outflows and reductions in banking system borrowing from the Fed. had done much to offset the expansionary effect of open market operations on the reserve base that was required for a serious and much needed expansion of the money supply.

The following *Memorandum* confirms the evidence of his other writings of the time that Currie did indeed advocate open market operations as an important policy measure in their own right. It is, moreover, particularly striking that, before the events of 1932, it also discussed in some detail the need to take into account the likelihood that the commercial banks' first response to such measures would be to reduce their indebtedness to the Fed.. Thus the stress that Currie laid on this same point in (1934) was in no way an *ex post* rationalization for the failure of open-market operations in 1932. It should nevertheless be noted that Currie and his associates turned out to have been unduly optimistic about the unlikelihood of open market operations provoking a gold outflow, nor is there any discussion here of the possibility of a build up of excess reserves in the banking system inhibiting their effectiveness.[16]

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[15]Indeed, an unpublished December 1934 memorandum to Marriner Eccles on "Confidence" is the earliest substantive item dealing with expansionary fiscal policy to appear in Sandilands' (1990) bibliography of Currie's work. In his January 1931 PhD dissertation, however, Currie did explore the links between monetary policy and the incentive to expand public works. Furthermore: "In so far as the policy of expanding public works in times of depression is adopted, and banks purchase bonds of public authorities, the additional bank credit will be spent directly and will not involve any decrease in the spending ability of private individuals" (Currie, 1931, p. 236).

[16]Though Currie largely anticipated Friedman and Schwartz's (1963) explanation of the Great Contraction itself, his intepretation of the later years of the Depression differs markedly from theirs, particularly over the matter of excess reserves. After 1934, Currie came to regard their

Most striking of all, however, the *Memorandum* shows that, as early as January 1932, Currie and his associates had concluded that the economic situation was sufficiently serious that open market operations alone might not be enough to deal with it: hence their advocacy of fiscal expansion. They were well aware of the potential for what we would now call “crowding out” effects to mute its influence, however, and argued (pp.15-16) the necessity of financing budget imbalances with money creation, particularly in the early stages of any such programme. Here it is worth drawing attention to a certain similarity between their views and those of Hawtrey. The latter is rightly regarded as the originator of the “Treasury view” that fiscal policy not financed by money creation would usually be fully crowded out, and that, when deficits were financed by money creation, it was the latter, and not any expenditure associated with the former, that would do the work. Nevertheless, Hawtrey (cf.1925, pp. 41- 42) did discuss possible exceptions to his basic position, allowing that an increase of confidence among the general public in an initially depressed economy could create a rise in velocity and prevent the effects on output of government expenditures being crowded out; but he also argued that this would only be possible if such policy was initially accompanied by money creation so as to permit a confidence-building expansion to get under way in the first place.[17]

It is also worth recalling that Currie’s later expositions of the case for expansionary fiscal policy invariably paid more attention to the interaction of such measures with the quantity and velocity of money than did more explicitly Keynesian treatment of the topic.[18] Evidently, these later expositions rested on principles that he and his colleagues had begun to develop while at Harvard in the early 1930s, and owed nothing to any later influence emanating from Keynes’ *General Theory.*

The Harris Foundation “Recommendations. . .”

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build-up as a sign that, whatever it might have accomplished up until the end of 1932, orthodox monetary policy alone was not likely to be effective in bringing about expansion unaided as the depression continued (See Laidler 1999, pp. 243-4 for further discussion). Friedman and Schwartz on the other hand treat this same phenomenon as a result of an increase in the liquidity preferences of a badly shocked banking system. Currie was among those who recommended the increase of reserve requirements in 1936-37, which, in Friedman and Schwartz’s (1963, pp. 520 et seq.) view, provoked a subsequent downturn in the money supply and recession in 1937-38. Currie attributed this recession to an inadvertent tightening of fiscal policy in that year. See Sandilands, (1990, pp.87 *et seq*.).

[17]See Laidler (1999, pp. 125-28) for further discussion of Hawtrey’s treatment of this and related matters.

[18]On this matter, see Currie (1978) and Sandilands (1990, pp.68 *et seq*.).

Finally we turn to the extremely strong similarities between the following *Memorandum* and the "Recommendations. . ." to President Hoover that emerged from the Harris Foundation conference of January 1932. These "Recommendations . . ." (along with Jacob Viner's contribution to the conference that produced them) are the earliest of the sources cited by Milton Friedman (1974, pp. 163-64) as epitomising the economics of the "Chicago tradition" of the 1930s, from which, he claimed, his own work ultimately drew its inspiration. Quoting J. Ronnie Davis (1968) he drew attention to Chicago economists' advocacy of " 'large and continuous budget deficits to combat the mass unemployment and deflation of the times' ", and went on to remark, now quoting from the "Recommendations. . .", that

> "They recommended also 'that the Federal Reserve banks systematically pursue open-market operations with the double aim of facilitating necessary government financing and increasing the liquidity of the banking structure.' (Wright 1932, p. 162)"

Friedman (1974) contrasted the "hopeful and 'relevant' view" epitomised by these passages with the

> "London School (really Austrian) view that I referred to in my "Restatement" [1956] when I spoke of 'the atrophied and rigid caricature [of the quantity theory] that is so frequently described by the proponents of the new income-expenditure approach. . ." (p.163)

Now Friedman was careful to note that the "Recommendations…" themselves bore the signatures of twelve non-Chicago economists, and he did not therefore claim that "this more hopeful and 'relevant' view" of what could be done about the depression "was restricted to Chicago" (1974, pp.163-64). If, however, we follow him in treating this as an important document of the early years of the Chicago Tradition, then a comparison of its contents with the following *Memorandum*, completed, it should be recalled, earlier in the same month, forces us to conclude that, at this stage in its development, there was indeed nothing at all unique about that tradition.[19]

[19] If, however, we follow Don Patinkin (1969) and George Tavlas (1997, 1998a, 1998b), and focus on advocacy of public works policies as a means of injecting money into circulation as a key characteristic of Chicago thinking, then it should be noted that a brief reference to this position occurs in Jacob Viner's contribution to the informal discussions that took place at the Harris foundation conference, during the session of January 29th on "What Should be Done in the Present Emergency". He argued (Norman Wait Harris Memorial Foundation, 1932, p.245) that earlier experience with public works expenditures were irrelevant to the current situation because, among other things, "none [were] connected with a program of expansion of currency or banking funds".

24 of the economists at the Harris conference signed a six paragraph document. As we have noted earlier, it urged President Hoover to support vigorous open market operations and public works programmes, (paras. 2 - 4); so did the Currie, Ellsworth and White *Memorandum* (pp.6-18), though the latter were more enthusiastic about the second of these measures than the signatories to the Harris conference "Recommendations…". The latter document also urged that the Federal Reserve system be empowered to issue notes against government securities, thus effectively increasing the amount of "free gold" available to the system (para. 1); so did the *Memorandum* (p.8). In addition the "Recommendations…" urged that attention be given to reducing or cancelling inter-governmental debts, and to beginning international negotiations with a view to securing a substantial reduction in tariffs and other trade barriers (paras.5 and 6); so, once again, did the *Memorandum* (pp.19-28).

The similarities between the two documents are so great that they are unlikely to have been totally coincidental. It must be recalled, however, that, contrary to later myths surrounding the so-called "Keynesian Revolution", support for vigorous open market operations was no novelty in the early 1930s - e.g., Keynes (1931), Hawtrey (1932) - nor was advocacy of expansionary fiscal policy - e.g., Pigou (1927), Robertson (1928), Douglas and Director (1931).[20] Thus, though the Currie, Ellsworth and White *Memorandum* and the Harris Conference "Recommendations. . ." might have appeared radical to some contemporaries, they were by no means unique in the literature of the time. Even so there is a direct connection between these two documents, in the person of a senior Harvard economist, John H. Williams. He was beyond doubt familiar with Currie's earlier

Steindl (1995, pp. 84-85) also quotes this passage, but cites Viner (1933) as the principal source for his advocacy of this typical Chicago position. Laidler (1999, pp. 187-9) also dates its emergence from 1933, and now notes that an explicit reference to Viner (1933) was inadvertently omitted from or edited out of this passage.

[20]Tavlas (1977, 1997, 1998a, 1998b) has long taken the view that Douglas is a key figure in the Chicago tradition, and that his (1931) book with Director (who was at that time his research assistant) is one of its important documents. In our view, that book's pessimism about the effectiveness of expansionary monetary policy puts it outside of this tradition as it is usually understood. Douglas's earlier and later under-consumptionism also seems to place him well beyond the bounds of any tradition related to the quantity theory. See Laidler (1999, pp. 206-11, 222-8) for an extensive discussion of this matter, as well as Steindl (1995, pp. 93-94). Note also that Douglas, though present at the Harris Foundation conference did not, in contrast to Director, sign its "Recommendations. . ." and that the tone of some of his exchanges with Viner, particularly that which followed Douglas's effort to present Ricardo as an advocate of managed paper money during the session of January 30th on "The Measurement of Monetary Phenomena" suggest that their relationship was anything but harmonious.

work, having supervised his thesis, and he not only signed the Harris recommendations, but also had a hand in drafting them sufficiently important to have been chosen by his colleagues to prepare an essay for the Harris Conference volume putting them in context (Williams 1932).

That essay, it must be said, makes no explicit reference to Currie, Ellsworth and White, nor did Williams refer directly to them or their *Memorandum* in his extensive contributions to the oral deliberations of the conference. Moreover, his essay has nothing to say about fiscal policy, despite the fact that one of the recommendations it was justifying was that "the federal government maintain its program of public works and public services at a level not lower than that of 1931-32". However, William's conclusions that

> "The greatest single help, internally, would be a vigorous open-market policy designed to reduce rediscounts of member banks and to increase the supply of purchasing power. The greatest help of international character would be the substantial reduction, or cancellation, of war debts, and the scaling down of tariff barriers"

echo not only the other "Recommendations . . ." emanating from the conference, but also, as we have already seen, proposals set out in great detail in the *Memorandum*. Furthermore, the transcript of the oral deliberations of the Harris Foundation conference shows that Williams stressed the importance of existing commercial bank indebtedness to the Federal reserve system as a factor affecting the likely efficacy of open market operations, just as the *Memorandum* does, and he also gave a quantitative assessment of the scale of open market operations needed to influence the economy that ran exactly parallel to a similar discussion in the *Memorandum*.

Where Currie, Ellsworth and White wrote

> "At the moment of writing, the indebtedness [of commercial banks to the Fed.] amounts to over $800,000,000. We strongly recommend, therefore, that the reserve banks purchase upwards of a billion dollars of bills and securities. This action would satisfy member banks' desire for liquidity and in addition give them large surplus reserves." (p.6)

Williams remarked

> "If we examine our situation today we would find that it would take something like double the present security holdings of the Federal Reserve banks merely to get the banking system out of debt. Apparently the first desire of the banking system would be to clear itself from debt, so that I can express my point . . . quantitatively by saying that it would take, for example, $1,600,000,000 of Federal Reserve assets merely to get ready to get started to pump money into circulation." (p. 294)

If he has not actually read the *Memorandum*, Williams demonstrably held essentially identical conclusions to its authors about the scale of open market operations that was needed at the beginning of 1932.[21] A Harvard view on a critical question of monetary policy was thus clearly represented at the Harris Foundation conference by one of the principle authors of its "Recommendations. . .". It is hard to believe, then, that these two documents are totally independent entities, nor is there any question but that the *Memorandum* was already in existence when the "Recommendations" were prepared.

Conclusions

To summarise then: the following *Memorandum* is interesting from a number of points of view. It provides concrete evidence that, whatever it may have been like later in the decade, in 1931-32 the

[21]The reader's attention is drawn to the fact that Williams here estimates the total *amount* of Federal reserve assets needed to *establish conditions* for the further pursuit of expansionary policy, while Currie, Ellsworth and White estimate the *amount by which such assets need to be increased* if monetary policy is to exercise an expansionary effect. According to Friedman and Schwartz (1963, pp.347-8), the open market purchase program of 1932, which lasted from April till July of that year, resulted in the system acquiring roughly one billion dollars worth of government securities. About half a billion of this increase was offset by an outflow of gold, but a reversal of gold movements thereafter saw gold holdings increase slightly over the year as a whole. However, discounts and bills bought (mainly the former) fell by half a billion between July 1932 and January 1933. Overall, the operation was sufficiently strong to keep the stock of high powered money expanding slowly during 1932, and to stabilize the growth rate of the money supply in the second half of the year. Note that Currie, Ellsworth and White who were optimistic that member banks "out of debt and in possession of surplus reserves could be… relied upon to bring about an expansion of deposits" (p.7) did not foresee the growth in the reserve:deposits ratio that would continue throughout 1932. But this was partly because they had linked their advocacy of open market purchases with a call for the government to increase its borrowings from banks, just as Currie (1931, p. 236) had done.

Harvard Economics department was the scene of vigorous and constructive discussion of the depression and how to deal with it, with an optimistic activist viewpoint well represented. Lauchlin Currie's role here has long been recognised, and this *Memorandum* throws important new light on it. It shows clearly that he was not a "lone wolf" ; more important, it provides a unique source of evidence on just how far his views on the use of fiscal policy had developed while he was still at Harvard, and how they fitted together with his monetary interpretation of the causes of the depression. Finally, the similarities between this *Memorandum*'s contents and those of the famous Harris Foundation "Recommendations. . ." of January 31 1932 provide conclusive evidence that many of the ideas that characterise the pre-*General Theory* "Chicago Tradition" in monetary economics, of which so much has been written in the last twenty five years, were also current at Harvard. To the extent that those "Recommendations. . ." are to be regarded as a pioneering document in that tradition, it also seems that it was influenced at an early stage in its development, through the contributions of John H. Williams to the Harris Foundation conference, by ideas originating at Harvard. For all these reasons, then, the following *Memorandum* is an important document.

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The depression has been in progress more than two years. During this period the index of business activity has declined over a third; unemployment has assumed very grave proportions; partial employment has seriously reduced the weekly earnings of a large proportion of those listed as gainfully employed. In terms of real income the depression has already cost the American people more than the Great War.[22] Nor can the loss be measured in terms of real income alone. The widespread and long drawn out period of unemployment and greatly reduced incomes has been accompanied by increasing physical suffering and anxiety. It has, further, engendered a loss of confidence in American leadership and American institutions which is becoming more marked as the depression lengthens.

The end is not yet in sight, nor can any precedent be used as a forecast of duration; the significant factors of the present crisis have no parallel in modern economic history. The situation has passed the bounds of a business depression and has assumed the aspect of an international calamity. With the reparations problem involved, economic distress thruout [sic] Europe on the increase, with the progressive maldistribution of gold reserves, the growing loss of confidence in banks, the mounting trade barriers, disorders in Spain, India, and China, the outlook for recovery in the near future in [sic] not encouraging.

In view of the manifest uncertainty as to the duration of the depression, the likelihood of its continuance for another year or longer and the failure on the part of the government to adopt other than palliative measures, there devolves upon the economist the responsibility of recommending a course of action which will hasten the approach of recovery. There are some economists who believe that the course of the depression cannot be checked, that political and economic changes are beyond human control, that to attempt to influence their direction is an attempt to interfere with the Anatural@ operation of economic principles; there are others who believe that the factors involved are so complex that economists can safely recommend no way out, and that the only policy to follow is

[22]In 1930 the national income, according to the National Industrial Conference Board, showed a decline from the peak year 1929 of 14 billion dollars, or 10 billion dollars from the average of 1927-28-29. For 1931 the decline has been considerably greater. During the three years 1917-18-19 the total federal government expendituresBconverted into 1931 dollarsBwere only about 17 billions, and of that sum a portion was expended for normal government purposes and a larger portion consisted of loans to the Allies. In the 24 months from January 1, 1930 to January 1, 1932 the loss has amounted to double the money expenditure caused by the war, and if the situation continues, it will double again before the year is over.

one of patient submission to the as yet little understood operations of economic maladjustments; there are even a few who believe that the depression should be permitted to run its course because they regard it as a vehicle for the wholesome purging of inefficiency from our industrial system. A great number of economists, however, are not in sympathy with such views; they believe with Dr. Persons that Athe depression will not cure itself and requires prompt, intelligent, and vigorous action@; they believe that recovery can and should be hastened thru [sic] the adoption of proper measures.

The recommendations recently made by Dr. Persons and signed by a number of eminent economists are a first step towards a vigorour [sic] grappling with the situation. We feel, however, that the proposals are stated in terms too vague, and the program offered is not sufficiently comprehensive to insure the desired goal of business recovery. We therefore venture to submit the following specific program together with a brief discussion of the economic principles involved.

<u>BANKING POLICY</u>

Production and prices have been and are falling, not because of a decline in the need for goods, but because of a decrease in monetary demand. This decrease, in turn, is due both to decreased monetary incomes and to the decreased spending of those incomes. Monetary incomes, broadly speaking, are determined by the volume and the rate of spending of the community=s means of payment, which consist of money and demand deposits. The banking system can influence the rate of spending only indirectly. It can, however, thru its control of demand deposits, control within wide limits the volume of the means of payment, and it can offset, to a large degree, changing rates of spending by changing the volume of the means of payment.

Our banking policy has not exerted any effective influence to check the decline in the means of payment. Instead of offsetting the decline in the demand for goods caused by the decreased rate of spending, our policy has intensified it by permitting a contraction of the volume of the means of payment. The contraction has resulted chiefly from the extremely high level of indebtedness of member banks to the reserve banks. This indebtedness arose from the necessity placed upon the member banks of meeting customers= demands for notes and gold, and it has been maintained at that high level by the action of the reserve banks, which, from October to the end of January, decreased their holdings of acceptances by some $600,000,000. A decrease in the holdings of acceptances reduces correspondingly the reserve accounts of member banks and so forces them to increase their borrowings from the Federal Reserve Banks. To reduce this indebtedness, the member banks resort to a policy of credit contraction.

Why, it may be asked should banks wish to reduce their indebtedness to the reserve banks? There are various reasons. In the first place, there is the understandingBvirtually an unwritten lawBthat recourse to the reserve banks should be for temporary and emergency purposes only. Continuous indebtedness to the reserve banks has, in the past, been frowned upon by the authorities. In addition there is the urgent desire of conservative bankers to be in a liquid condition, and it is considered that borrowings impair liquidity. For these and other reasons, member banks have been selling bonds in unprecedented amounts and have not been renewing old loans nor making new ones. As a consequence we have been experiencing an enormous contraction of demand deposits.

The results of this contraction have been uniformly unfortunate. It has unquestionably contributed to the demoralization of the bond market, and so to bank failures and the postponement of bond issues for construction purposes. In addition it has deepened the depression in less obvious ways. When an individual having a deposit buys a bond from or pays off a loan to the banking system and the system cancels the deposit, precisely the same effect is brought about as if the

government were to issue bonds for banknotes and then destroy the banknotes. Individuals acquire means of payment from current production; they save, that is refrain from exercising a demand for the goods they have contributed in producing, and with their savings pay off a loan or buy a bond. If the bond is issued by a borrower who uses the proceeds to finance construction, no net decrease in spending or demand for goods has taken place. If, on the other hand, it is bought from a bank, as has recently been the case, the deposit is wiped out and a net decrease in the demand for goods is the result. In other words, a deposit which is not spent by the original owner on goods cannot, since it has been wiped out, be spent by anybody.

Obviously, continued liquidation of this nature will hinder any plan to overcome the depression. It is of the utmost importance, therefore, that liquidation be terminated as soon as possible. We do not believe that it will be terminated as long as member banks are so heavily in debt, and we believe, therefore, that it is absolutely essential for the indebtedness to be reduced. How can this be done?

Broadly speaking, indebtedness to the reserve banks can be reduced in four ways: (1) by an inflow of gold; (2) by an inflow of money from circulation; (3) by purchases of bills and securities by reserve banks; (4) by a contraction of member bank loans and investments and hence of deposits. A contraction of deposits sets free a proportion of the member banks= reserves which can be used to pay off rediscounts with the reserve banks. It is, however, important to note that a reduction of a billion dollars in deposits reduces reserve requirements, and hence rediscounts with the reserve banks, by only one hundred millions (assuming a 10 per cent reserve ratio). In default of the first three ways member banks have been forced to have recourse to this last method of reducing rediscounts. After four months of contraction, however, they found themselves more heavily indebted than ever, owing to the diminution in the holdings of acceptances by the reserve banks.

Since we dare not wait for an inflow of gold or of cash, and it is obviously undesirable that banks should continue to reduce indebtedness by contracting deposits, the only alternative is for the reserve banks to enter upon a vigorous open market purchasing policy. At the moment of writing the indebtedness amounts to over $800,000,000. We strongly recommend, therefore, that the reserve banks purchase upwards of a billion dollars of bills and securities. This action would satisfy member banks= desire for liquidity and in addition give them large surplus reserves. Member banks, out of debt and in possession of surplus reserves, could be relied upon to increase their holdings of short term government bonds and in this way bring about an expansion of deposits in place of the present contraction.

The reserve and member banks= purchases of bonds would aid in the recovery of the bond market and this, in turn, would enhance the solvency of bond holding institutions and would enable borrowers to secure loans at better rates. Further, this policy would unquestionably result in an increase in consumers= incomes, demand for goods, and production. What is needed at the present time is a net increase in the effective demand for goods. If the government borrows from the reserve banks and other banks, it receives deposits which have been newly created and which have not been taken from individuals. In this way a net increase in spending can be achieved. If, however, as is pointed out elsewhere in this plan, the government attempts to finance its deficit solely by taxation, or even by bonds sold to individuals, there is a probability that most of the increased government spending will be offset by the decreased spending of taxpayers and bond buyers.

An objection to our proposal that the reserve banks buy bonds, which probably carries some weight with the reserve administration, is that it would decrease the Afree gold@ of the system. There is a provision in the Federal Reserve Act that federal reserve notes must be backed 40 per cent by gold plus 60 per cent by eligible paper or gold. Member bank rediscounts secured by government securities bought in the open market are not. If, therefore, a policy were adopted which would result in the displacement of bills discounted by government bonds in the reserve banks= earning assets, the amount of gold that would have to be held against notes would be increased. We believe that this provision in the act has no valid justification and recommend, therefore, that government bonds be declared eligible as collateral against federal reserve notes. The reserve banks need not, however, wait for a change in the law. Their reserves are ample, and in any case they could purchase at least $600,000,000. of acceptances if they raised their buying price sufficiently. Acceptances are eligible paper.

Some people feel that an increase in means of payment would have no perceptible effect since, they say, there is plenty of money now; the real difficulty is in getting it spent. We can dispose of this objection very briefly by pointing out that we have provided for the spending of the increased means of payment by linking the plan for deposit expansion to one providing for public works with no immediate rise in taxes. If there is one point on which everyone is agreed, it is that any money borrowed by public bodies will be spent.

A criticism of an entirely different character is that our proposal is Ainflationary@. It should be noted that the people who make this criticism concede fully the efficacy of a policy of expansion on the part of the central bank. Their fear is, apparently, than an upturn started in this way would get out of control and eventually involve us in a situation similar to that of war time. We do not

believe that there is the slightest justification for this fear. We concede and, indeed, think it desirable that some recovery in prices should take place. In this connection, it is important to distinguish between an increase in monetary incomes when the factors of production are fully utilized and when they are only partially utilized. In the former case the output of goods can rise but slowly. In the latter, which corresponds to the present situation, an increase in monetary demand for goods could very shortly be met by increased output. It is only after much of the present enormous slack in our economic system has been taken up that the danger of inflation becomes real. Before that point in [sic] reached, the production of goods and services will have greatly increased. This additional production in answer to an increased demand is just what is wanted; it is the very goal of our economic system . As Keynes has so aptly said, ATo bring up the bogy of Inflation as an objection to capital expenditures at the present is like warning a patient who is wasting away from emaciation of the dangers of excessive corpulation.@ It is true that an approach to prosperityBi.e., the upswing in the movement of business activityBbrings with it danger of inflation; the very nature of expanding business activity contains the impetus to expanding bank deposits and rising prices. But the danger can be avoided, as it has been in the past. The reserve banks will be in an excellent position to apply brakes on the upswing by virtue of their very large holdings of bills and securities which they can sell and so place member banks heavily in debt. We find it difficult to understand why the spending of newly created means of payment should be any more inflationary than an increased rate of spending of the existing means of payment, which is universally advocated today.

It may be objected that a banking policy designed to check deflation would result in such an outflow of gold as to endanger the maintenance of the gold standard here. Our present gold stock is, however, approximately four and a half billions. French balances in this country were variously estimated in January to amount to between $400,000,000 and $450,000,000 and were being steadily reduced. Other foreign balances are much smaller. We could, therefore, well stand, if need be, the loss in gold of all foreign balances. It has been intimated that foreigners would also sell their holdings of our securities for gold. This is, of course, a matter of opinion and is, by its nature, incapable of definite refutation. We can only state it as our belief that such a reaction is unlikely. It seems more probable that a continued fall in our stock and bond prices would cause more foreign selling than would arise in those brought about by the anticipation of business recovery.

It must be remembered that only a few countries remain on the gold standard, and that they have received enormous quantities of gold in the past two years. It appears doubtful that they could absorb the upwards of two billions that we could spare, without any effect on their internal price structures. As long as the United States continues, by its policy, to raise the value of gold, central

banks in countries off the gold standard feel constrained to adopt restrictive measures in order to prevent continued depreciation of their exchanges. Should we succeed in starting a business recovery independently, it is probable that foreign exchanges would move initially against us. This would enable central banks in countries off the gold standard to relax their present drastic restrictive policies and pave the way for a world upturn. It need hardly be pointed out that a policy which leads to an increase in our aggregate money income to be spent on both home and foreign goods would do much to lighten the pressure on Germany and other debtor countries without causing any diminution in demand for home goods.

In conclusion, we believe that the most serious danger to the maintenance of the gold standard would be an internal drain of money into Acirculation@, which would result from a policy of continued liquidation. Such a policy, involving a steady decline in all values, would result in increased bank failures, which, in turn, would lead to increased hoarding. Suspensions of specie payments in the past have occurred as a consequence of internal rather than external runs on our banking system.

PUBLIC EXPENDITURES

While it is true both that an easing of credit conditions will tend to encourage private investment, and that any increase in credit, resulting in greater expenditure, will create additional employment, it is doubtfulBin the present situationBwhether the desired increase in private borrowing will take place. With confidence as badly shaken as it is at present, and with prices continuing to fall, there is little in the current outlook to make it attractive to business men to borrow in amounts sufficient to stimulate recovery. And while presumably the fall in prices will some day stop and confidence revive, the policy of waiting for this day to come involves us in a continuation of the present unemployment and business losses for an indeterminate period. Such measures as the National Credit Corporation and the Reconstruction Finance Corporation are in the main designed to prevent the liquidation from becoming more serious, not to give business an impetus which would start it on the upward path.

Since the initiation of a voluntary program of expansion by independent, scattered producers must wait upon the appearance of the prospect of profits, and since the Federal Government is the sole agency in a central position and strong enough to undertake drastic remedial action, it is strongly recommended that the Government immediately commence a program of public construction on a nationwide scale. Such a program would stimulate directly the building and construction industry and those industries engaged in the production of raw materials and tools, and indirectly a large number of other lines of enterprise, thru the expenditure of the earnings of the re-

employed. The revival of these industries would involve a further, secondary increase in employment, which in turn would stimulate recovery in other lines in ever widening circles. As employment in industry at large increased, a gradual reduction in government expenditure on construction would be called for, and would permit the return of men engaged on such work to their ordinary occupations.

This program should be financed, not by taxation, which serves principally merely to divert expenditure from one channel to another, but by an issue of bonds, under conditions specified below. It is recommended that United States bonds be issued in amounts sufficient to the purpose. The bonds should be sold, not in one block, but after an initial issue of $500,000,000, at such a rate as the progress of construction makes necessary. It is expected that it will not be necessary to issue more than one to two billions to achieve the desired results. These bonds should be made eligible for rediscount at the Federal Reserve Banks, and also as collateral for the issue of Federal Reserve notes. Partial retirement should be provided out of a surtax on incomes, the remainder out of generally higher taxation to be imposed as soon as recovery has been attained, the retirement to take place as rapidly as is consistent with the state of business activity, preferably at a rate of 15 per cent a year. Public utterance of prominent individuals to the contrary notwithstanding, it is deemed obvious that a period of national poverty is the worst time to increase federal taxes, and a period of prosperity the worst time to reduce them.

Increased taxes result normally in a transfer of purchasing power from the individual to the government; it is only when taxes come from hoarded or idle funds that an increase rather than a transfer of purchasing power results. If the government employs this purchasing power (i.e., collected taxes) instead of borrowing Acreated@ or idle funds, the result is a drop in the effective demand for bonds at a time when the government should be doing everything in its power to build up the effective demand. When at the same time the government adopts a policy of retrenchment, of ruthless cutting of expenditures, the effect is doubly bad. In times of intense depression a paring down of productive expenditures that can be financed thru the borrowing of Acreated@ or idle funds is inexcusable. A course of action which may be proper for a private corporation, for a municipality, for a state, or for some other country is no criterion of the proper policy for the United States Government. The City of New York may find it expedient to reduce its deficit, notwithstanding the resulting intensification of the depression, because it may not be able to borrow unless it reduces its budgetary deficit. If the important bankers refuse to support a municipal loan, New York has no alternative; it must reduce its deficit by increased taxes and decreased expenditures. But the United States Government is never in such a predicament; it always has a

choice: it can make possible such credit conditions as will facilitate the flotation of its bonds, and can, if necessary, even supply the funds with which its own bonds may be purchased.

It cannot be emphasized too strongly that financing public works through domestic bond flotations by the federal government does not saddle future generations with a burden. Even the 25 billion dollar loan raised to finance the war did not pass on to later years and portion of the burden of conducting the war. It doubtless caused in later years some redistribution of the national income (to what extent and in what direction involves an analysis of the incidence of the taxes raised to liquidate the loan and of the factors connected with the rapidity of liquidation, changed rates of interest, effect of loan and redemptions on prices, etc.Bmatters extremely complex for the economist and wholly beyond the laymanBbut it did not decrease the aggregate real income. The economic burden of the war on future generations consisted of the loss of benefits that would have been derived from the use of such capital, actual and potential, as was destroyed. The loss of future generations would have been neither more nor less had the war been financed wholly out of current taxes. Those who reiterate that domestic borrowing by the Federal Government saddles future generations with a burden should familiarize themselves with the A B C of economics. It is the failure of the Federal Government to increase its outstanding indebtedness during a period of depression that in a sense saddles the future with a burden; the capital goods that could be and are not produced deprive the future of the continuous stream of utilities that would have been derived from those capital goods. Every month=s delay in setting idle equipment and idle men to work not only denies to us currently an enormous amount of consumer=s goods and service, but also deprives future generations of the utility to be derived from the additional factories, schools, parks, roads, machinery, and so forth that could be produced if the Government now embarked on the program here outlined.

It is claimed that any large issue of bonds would destroy confidence in the United States Government and cause the value of its outstanding bonds to decline seriously. Such objection is wholly unwarranted. From 1921 to 1929 the Government reduced its indebtedness from 26 to 16 billions. Had the Government deemed it expedient, it could without difficulty have maintained the higher tax rates and by 1929 wiped off another ten billions of the debt. But it chose rather to lower taxes and to reduce the debt less rapidly. In 1930 the debt was 16.8 billion dollars, or about $134 per capita, a sum less than one-third the per capita indebtedness of France and less than one-fifth that of Great Britain. The tax burden in the United States, on the other hand, is considerably less than in either of these two countries. The United States, in short, has (in per capita terms) a much greater income, a smaller debt, and considerably lower taxes than any of the great nations. In the

light of these facts there are those who continue to affirm that if in this emergencyBan emergency certainly as great as the war if privation and national loss be the measureBthe outstanding domestic debt is to be increased by a few billion dollars, confidence in the United States Government will be destroyed. Those who make the claim point to the decline in the price of United States Government bonds during the fall of 1931 as evidence of a loss of confidence, but there is no sound basis for such a view. A loss of confidence in the financial stability of a government is quite different from a loss of confidence in the financial stability of a corporation or municipality. In the case of the federal government it does not and cannot mean that the government is in any danger of suspending payment on its domestic debt. It can mean only that the government may cease to pay its debt in money redeemable in gold; in other words, that the government is in danger of being forced off the gold standard. If such fears were entertained in the fall of 1931, the first sign would have been a hoarding of gold, and we know that this did not occur. Hoarding took place, but it was the hoarding of paper money, not gold, and indicated a loss of confidence in the banks, not in the Government. The decline in government bond values was caused definitely not by loss of confidence, but by the suddenly increased supply of bonds coming from those banks which were liquidation [sic] their investments in order to reduce their indebtedness to the reserve banks.

It is to be expected that a great increase in the demand for funds would probably depress the bond market unless the Federal Reserve Banks or member banks come to its support, as they did during the war, by purchasing a large portion of the government issues. Indeed, such action by the Federal Reserve Banks will be essential to the success of the plan herein outlined; otherwise a large bond flotation will heighten the long term borrowing rate and discourate [sic] new undertakings on the part of private corporations and municipalities. A result to be sedulously avoided. The Federal Reserve Banks need support the market with large purchases only at the start of the program. Once the upturn in business activity begins, there will be a return of business optimism, confidence in the banks will be revived, and the 1.3 billions of hoarded funds, which the Government is trying to Acoax@ and Areason@ back, will flow of its own accord (either by direct deposits or by the purchase of securities) into the banks. The demand for securities brought about by the inflow of hoarded funds will alone prevent the interest on long term borrowing from rising.

It has also been claimed that such a large government loan would merely have the effect of causing an equal decline in private investment. In view of the fact that new corporate issues of securities during the last six months of 1931 averaged well under $100,000,000 per month, the lowest figure since 1918, this is hardly a serious objection at the present. The proposed rate of issue of new government securities would far offset even a complete abandonment of private investment.

Furthermore, as the effects of the increased expenditure on employment, prices, and profits began to be felt, the prices of industrial securities could scarcely fail to rise, and as business revived, new industrial issues would be needed and would appear. Better security prices would be the inevitable result of rising monetary incomes of corporations. Again, more profitable business would mean both higher taxable capacity and higher tax returns, and this, together with the diminished burden of unemployment, would raise the value of the securities of states and municipalities, many of which have recently been forced to abandon their own public works programs because of low revenue and high cost of borrowing.

The program should begin with the letting of contracts to private contractors to an initial sum of $1,000,000,000, the work to be pushed as rapidly as possible; where feasible, by the employment of two or three separate shifts a day. In the awarding of the first group of contracts, preference should be given to those works that can be completed within the shortest possible time. It is essential that enough contracts be completed each month to make possible a decrease in total expenditures as business conditions improve. The emergency nature of the expenditure should be kept uppermost in planning the details. A high rate of expenditure at the outset should be aimed at, and bonds sold as rapidly as need be to meet the payments coming due. In view of the large number of public projects that have been postponed thruout the country by states and municipalities, it should be possible in a short time to achieve a rate of expenditure of $300,000,000 per month. As the stimulus of this expenditure spreads to other lines of activity, the rate of expenditure should be reduced. The value of contracts let after the first billion is spent should be scaled down as the index of production of the Federal Reserve Board rises. Then the index reaches 90 (in 1928-29 it averaged 114), only those projects as yet incomplete should be finished and no new contracts should be let in.

The expenditure of the emergency funds should be governed by the following considerations: (1) facility with which projects may be initiated at the earliest possible date and completed within a short time; (2) amount of labor that will be employed, directly or indirectly; (3) number and diversity of the industries which will be affected, directly or indirectly, by the projects; (4) value of the projects to the economic and social welfare of the country; (5) economical administration of the work. While waste and duplication should be avoided so far as is humanly possible, the object of the expenditure is to put men to work as useful tasks immediately instead of waiting until we are forced to relieve them in idlenessBhence the emphasis on speed and on the numbers employed.

As to the objects upon which the funds should be spent it is clear that there is a wide variety of useful public works which need to be undertaken, and which, if done, will leave the country definitely ahead in a tangible way. Specifically, it is recommended that the proceeds of the loan be used in the construction of roads, the elimination of grade crossings, the erection of bridges and public buildings for which there is a clear need and for which plans are ready, the elimination of unsightly areas in municipalities, and in carrying out a program of flood prevention and reforestation, both directly by the Federal Government and toru [sic] loans to states and thru [sic] them to municipalities. In order to ensure a coordinated policy in the execution of the program of construction, it is recommended that there be created an Administration of Public Works, along the lines laid down in the bill (S. 2419), presented to the Senate by Senator La Follette.

It will doubtless be argued that such public work will be costly, that some things will be done which do not seriously need doing, and, in general, that such vast expenditure by the Government is unwise. Admittedly the work done will probably involve a larger outlay than ordinary public works, but it is the object of the program to meet a specific emergencyBmen are to be given employment because they are unemployed. The alternative is direct unemployment relief, which, to be adequate, would require a large outlay, would leave nothing behind to show for the expenditure, and would prove demoralizing to the recipients.

Innumerable difficulties lie in the path of a rapid and successful execution of so large a program. Yet those difficulties are not insurmountable. In 1917 the United States demonstrated its ability to execute a far more difficult program. The seriousness of the present emergency warrants the straining of every effort to achieve quickly an adequate rate of public expenditure which will do so much to bring about business recovery.

TARIFF POLICY

One of the factors that has in no small way contributed to the present world wide depression and is an additional obstacle in the way of recovery is the determination on the part of the nations to keep out goods of other countries. Since 1925 th [sic] tariff schedule of every important country has been revised upward at least once. Not content with mere increases in duty, many countries have set up import quotas, licensing restrictions, and embargoes. Germany in a desperate attempt to prevent an outflow of gold has instituted a system of licensed imports and control over foreign exchanges, designed effectively to cut her imports to the bone. Austria, Czechoslovakia, Turkey, Greece, Jugoslavia, and Roumania exercise close control over exchange, and Spain, incensed by the restrictions imposed on her exports, has recently retaliated with import quotas. Even France, whose gold reserves are in no way threatened, is adding import quotas to her already high tariff schedule. This concerted rush to place more and more obstacles in the path of international trade has operated to increase not only the real costs of production of innumerable international commodities, but also the maladjustments which are now playing economic havoc. The relationship between the world supply and demand of many important world commodities has been seriously disturbed: the present ruinous prices of wheat, sugar, textiles, and a host of other manufactured articles are in part traceable to the policy of expanding home industries and domestic crops by means of subsidies provided by protective duties, regardless of the fact that in the exporting countries crop areas and plant capacities are not reduced until long after prices have become ruinous.

Heightened tariff barriers, by rendering more difficult the adjustments of international accounts, have magnified the problem of debt settlements, both private and public, and have contributed materially to the maldistribution of gold reserves. The higher the import duties in the creditor countries, the harder the task of developing export surpluses in the debtor countries. Forced to adopt extreme measures to develop the export surplus necessary to meet payments abroad, the debtor countries have cut imports to a minimum, and have maintaimed [sic] high discount rates. The difficulty of developing a sufficient export surplus has in some cases led to virtual abandonment of the gold standard. The concentration of gold in the United States and France, where it is not needed, at the expense of gold reserves in countries where its loss proved disastrous, has been encouraged by their high tariff policies. In an attempt to stem the outward flow of gold or encourage an inflow, tariff barriers in other countries have been increased, and have in turn incited retaliatory increases. And so the mad march toward declining trade, increasing costs, and economic maladjustment goes on.

The United States has been in the forefront in the building up of tariff walls; it is only fitting that she take the lead in the downward revision so necessary to a return to economic sanity. A step by her in that direction may well initiate a general reduction in the tariff schedules of all important countries, but whether or not other countries, follow America=s lead, the reduction of import duties in the United States would be an important step towards economic recovery and a means of increasing the real aggregate national income. We therefore recommend a reduction in all duties protective in design or in effect. We indorse also that portion of the tariff bill (now before Congress) calling for the creation of a commission to confer with European governments with the express intent of securing the scaling down of tariff schedules. International conferences, however, are certain to be long drawn out, and the present situation calls for immediate action. Let the United States by a reductionin [sic] her import duties demonstrate to the world that she no longer will contribute to the dangerous spirit of unenlightened nationalism and international bitterness which high protective policies foster.

It is important to recognize, however, that a sharp reduction of duties would involve injustice to vested interests in the protected industries, and would result in additional short-time maladjustments. The diversion of capital and of workers from protected industries to others should be so gradual as to cause minimum losses to the owners of protected industries and a minimum of additional temporary unemployment. It is therefore recommended that all import duties in excess of twenty per cent ad valorem be reduced by one fifth of the existing duty. Such a reduction would avoid serious maladjustments and losses: many of the duties in the present schedule, being much in excess of the differences in the domestic and the foreigh [sic] costs of production, would continue to keep out the foreign commodities; others, being completely ineffective, would merely continue so; while commodities taxed twenty per cent ad valorem or less (the ad valorem equivalent of specific duties to be based on the average import price of 1930) would not be touched by the revision. The employment of a flat rate of reduction applying to all commodities (except those taxed twenty per cent or under) would have a double advantage: it would obviate the delay and the uncertainty of lengthy consideration of the separate items, and it would immediately make clear to the world that an important downward revision of the tariff schedule had been made. The proposed reduction would have, we believe, a beneficial economic effent [sic] out of all proportion to the actual changes involved.

REPARATIONS AND INTERALLIED DEBTS

We feel confident that the adoption of the foregoing recommendations in regard to banking policies, public works, and the tariff will bring about business recovery in the United States; but we cannot overlook the fact that extreme distress in Europe must end to retard our progress. Europe consumes normally one-fourth of our exports, and the sharp decline in her demand for our products will continue to be a depredding [sic] factor in many of the export industries, particularly in agriculture. Americans have invested, moreover, five billion dollars in European countries, and the income from these investments has been curtailed by the depression abroad. We believe, therefore, that business recovery in the United States will be more easily attained, and will reach a higher level, if accompanied by recovery in Europe.

Reparations are the chief obstacle to European prosperity. They hang like a storm cloud over Europe, presaging possible chaos, shutting out the influences essential to a resumption of normal international relations, and inducing a state of mind wholly inimical to business recovery. In GermanyBthe crucial country, whose situation so largely affects conditions in the rest of EuropeBthe very high interest rates, the budgetary difficulties, the interference with the normal course of trade, the precarious banking situation, are all in a large measure a consequence of the reparations tangle. Unemployment is now approaching six millions, and political strife is assuming more and more a threatening aspect, while the growing determination among all parties in Germany that reparations be cancelled, or at least greatly reduced, is keeping France in a state of great uneasiness that is reflected in increased hoarding, a cautious banking policy, and a growing pessimism.

The Young Plan has not provided a solution to the reparations problem; payments are not being made, and there is little likelihood that they ever will be made on the scale fixed by the plan. Germany balks at the prospect of saddling the next two generations with burdens she holds them to have in no way merited, and is becoming less and less inclined to submit to terms she believes to be unreasonable. Any attempt to force from Germany larger payments than she is willing to make can result, as France discovered in 1923, only in disaster to all concerned. It is evident, therefore, that German reparations must be revised, and in a manner that will receive the co-operation of the German people.

Interallied debts are, as every economist recognizes, inextricably bound up with reparations. It may be political wisdom for United States government officials to continue to deny that such is the case, but the fact remains that France will not make her annual payments to the United States and England if she does not receive annuities from Germany, and that England will not pay the United States if Germany and France default in their payments to her. An extension of the

moratorium will not be a settlement of the tangle; it will serve merely to perpetuate the uncertainty. If, on the other hand, a definite and permanent arrangement be made on a basis satisfactory to the principal nations concerned, Europe will be rid of the great impediment that bars the road toward her economic recovery. With intergovernmental debts permanently out of the way, the next decade may well see a great stride towards a higher standard of living and better international relations.

We believe that the quickest, most equitable, and most effective way to settle the problem of reparations is thru a complete cancellation of interallied debts and reparations. The principal justification for cancellation rests upon other than economic grounds, but our economic interests alone, we believe, warrent [sic] the step. The greatest monetary loss of such a settlement would fall upon the United States, yet if by a cancellation of all intergovernmental debts we can achieve a ten per cent higher level of business activity, even for a single year, the United States will have lost nothing, while Europe will have gained much. Those who oppose cancellation on the ground that the American people would lose $300,000,000 a year, base their attitude on the questionable assumptions that the Allies are going to meet their obligations, and that intergovernmental debts in no way retard economic recovery or prevent a higher level of prosperity. As we have pointed out, whether or not the United States receives $300,000,000 a year depends upon whether or not Germany pays her reparations in accordance with the Young Plan. Germany, we repeat, will not make those payments, and cancellation, therefore, does not mean a loss of $300,000,000, for in no case would the United States receive this sum. Cancellation would mean an end to the bickerings, moratoriums, uncertainties, political and economic disturbances, and international frictions which are contributing so much to the downward movement of business activity in Europe, and which cannot but affect the situation in the United States. But public sentiment, however unjustified, remains strongly opposed to cancellation. We recommend, therefore, as an alternative the following plan, which while gaining the support of those who resent cancellation, will achieve a measure of its benefits.

The United States loaned the Allied Governments about ten billion dollars. This sum, compounded at 4 2 per cent annually would amount to 15 billions. Of this sum 2.5 billions have already been paid, leaving the current indebtedness, on the foregoing basis, at 12.5 billions [sic]. (For purposes of brevity only approximate figures are used.) At the time these funds were loaned the purchasing power of the dollar was about one-half what it is today. Since it is palpably unfair to expect our allies to pay back double the amount of goods and services they borrowed for the conduct of a joint war, the sum owing to the United States ought to be adjusted to its present purchasing power. In terms of 1932 dollars the debt to the United States would be only 6.25

billions. This sum of 6.25 billions, it must be emphasized, represents no real reduction from the amount borrowed by the Allies plus the interest which would have accrued from the date the loan was made until the present time. However, in its arrangements with the various debtor countries, the United States has already demonstrated its willingness to scale down the real burden of the debt. In its agreement with Italy the effective reduction, in view of the low interest rate and dates of payment, amounted to 74 per cent; with Belgium, 46 per cent; with France, 50 per cent; with England, 18 per cent. If these reductions were applied to the deflated value of the loan (namely, 6.25 billions), the remainder due the United States would be 3.75 billions. The reduction of 2.5 billions, or 40 per cent of the debt, would then be the contribution of the United States toward a permanent settlement of the debt problem, the reduction being contingent upon a similar treatment of German reparations. The annual loss of revenue to the United States from the 2.5 billion dollar reduction would be a negligible portion of our annual income, and would be much more than offset by the good results of a permanent solution of the inter-allied debts and reparations problem.

We recommend that this 3.75 billion dollar debt be paid in the following manner:

Each country will give to the United States, in place of bonds already given, its bonds, bearing an interest rate of 7 per cent per annum, payable in gold, to an amount equal to the sum due the United States after correction is made for the changes in the purchasing power of gold, and after the reductions listed above for each country are made. The bonds will be equally divided into three classesBA, B, and C,Bthe only difference in the classes being the date and the callable price. Class A bonds will be dated August 1, 1932, and will be callable (by lot) for the first two years at 103, and thereafter at par; Class B bonds will be dated August 1, 1933, and will be callable for the first three years at 110, during the second three years at 105, and thereafter at par; Class C bonds will be dated August 1, 1934, and will be callable during the first three years at 115, during the next three years at 110, during the following three years at 105, and thereafter at par. All bonds will be payable in 20 years, with redemption required at the rate of 2 per cent, beginning in the seventh year and increasing at the rate of 2 per cent every second year. This splitting of the bonds into different classes would delay maximum interest payment until 1935.

The United States Government will offer these bonds to the public at not less than par. Because of the attractive rate of interest, the bonds will be rapidly absorbed by individuals and banks in the United States. The sale of these bonds will not depress the bond market, because the proceeds will be used to liquidate its own bonds; in fact, it might be easily arranged to permit the holders of United States government bonds to exchange them for the 7 per cent foreign government bonds. The debts to the United States Government would thus be liquidated and removed from the

field of governmental consideration. To prevent exchange difficulties arising in the issuing countries from a possible extensive purchase of these bonds by the residents of the issuing countries, a tax could, if necessary, be imposed by those countries on their purchase or interest payment.

Improvement in the credit of the debtor governments is certain to follow a satisfactory solution of the reparations problem and the return of prosperity. The issuing governments could then refund one-third of the loans at a lower rate of interest, followed by another third three years later, and so forth. Before ten years had passed, the interest payments would in all probability have been reduced one-fourth by virtue of the lower rates, made possible by improved credit conditions. A portion of these bonds would doubtless replace some of the foreign securities now held in the issuing countries, and the transfer problem would thereby be further reduced.

A settlement of the debts in this manner is conditional, of course, upon a similar settlement to be made by the Allied Governments with regard to reparations. The Young Plan fixed the remainder of reparations due from Germany at 9 billions. Since the payments already made under this plan have amounted to no more than the interest on that amount, the reparations due remain at 9 billions. In terms of 1932 dollars this sum would equal about 6 billions [sic]. From this sum is to be deducted an amount equal to the reduction made by the United States to the AlliesBnamely, 40 per cent. This will leave about 3.6 billions [sic] due from Germany to the Allies. In settlement of this debt Germany will give to each of the Allies, in such proportion as shall be agreed upon among themselves, German Government 7 per cent bonds, payable in gold. The service on those bonds shall have priority over any other government loan except the $300,000,000 loan of 1925. The bonds, like those given to the United States by the Allies, are to be divided into three classes with the same provisions. The first payment to be made by Germany would be $84,000,000 in 1934, followed by $168,000,000 in 1935, and by $252,000,000 in 1936. Under the Young Plan the annuities were to $450,000,000 in 1934, $465,000,000 in 1935 and $475,000,000 in 1936. The new plan thus considerably reduces the transfer problem. As soon as Germany=s credit improves, she can refund the 7 per cent bonds for others bearing a lower rate of interest, and, if advisable, reduce the rate of redemption. The transfer problem may thus be reduced still further.

Under the favorable conditions following the virtual elimination of the transfer problem and the reduction of Germany=s debt, the 7 per cent bonds will pass into the hands of private holders. Once this occurs, the reparations problem will lose all political importance and will cease to be a distrubing [sic] factor in international affairs. Long before this final absorption of the bonds takes

place, however, Europe will have been relieved of the demoralizing burden of uncertainty and fear, and will have taken forward steps toward prosperity.