All Hottentots or Millionaires

By Norman Lombard

Who, agreeing with Edward F. Harvey that the Administration policies are inadequate, suggests a different monetary control

Since the remedies for the depression thus far tried have not been altogether effective, it will not, perhaps, be considered unpatriotic if we analyze some of the popular fallacies of current thinking on which those remedies rest, and consider alternative measures that have not yet been given an adequate trial.

The basic fallacy of our times is our old friend, the "mercantile theory." Probably this error of thinking has been the greatest stumbling block to economic progress in all times.

The mercantile theory would lead us to believe that nations get rich by increasing their supply of money rather than by increasing their production of goods. It grows out of the natural feeling that, since men get rich by "making money," by piling up money and claims on money, therefore the same rule must apply to nations. This is not true; but we can not understand the error unless we understand money. And our vagaries on that subject arise out of a fundamental misconception as to what it is and a confusion of the terms "money" and "wealth."

In the widespread acceptance of the mercantile theory lie the explanations of such phenomena as the perennial opposition to the use of labor-saving machinery; the common belief in the desirability of a "favorable balance of trade," with its consequent confusion over the subject of intergovernmental debts; and a group of four interrelated fallacies which are the immediate subject of this discussion. These are the belief that overproduction caused the drop in the general level of prices that brought on the depression; the belief that a country can be made prosperous by limiting production; the belief that, by increasing wages and shortening hours of labor, spending will be increased; the belief that governmental spending, as for public works, adds to the total purchasing power.

The most dangerous of these four fallacies is the belief that the drop in the price level that brought on the depression was caused by overproduction. We are plowing up growing cotton; domestically and even by international agreement we are trying to limit the production of wheat; we are destroying sows in farrow as a means of reducing the world's supply of pork; we are reducing the hours of employment or the output per man in factories, even going so far as to prohibit the introduction of new labor-saving machinery and to restrict the entrance of capital into the erection of new factories. How long will it be before we start dynamiting a portion of each existing factory, burning down dwellings, filling up mines?

There is a deep-seated mistrust of these activities. Every one feels that there is something inconsistent in destroying food when men are hungry, but the idea nevertheless persists that, from a social point of view, production must be restrained; that it is uneconomic; that it leads to catastrophe.

Some say that the steps currently taken are necessary to meet a temporary situation. They say that we have, at the moment, too much wheat relative to other things and that, therefore, we must grow less wheat, or that we have too much sugar, and the remedy is to produce less sugar.

There is an obvious lack of consistency between these efforts toward lessened production and governmental activities to increase production, as in the fight on the boll-weevil and the Mediterranean fruit fly, in the efforts to bring new farm lands into use by irrigation and drainage, in power-plant construction, in the intensive scientific search for means to increase farm yields and the output per man in industry.

Further evidence of the instinctive feeling that there is something unsound in the overproduction theory is seen in the efforts to increase buying power by "spreading work," under the NRA, or in the proposals to expand governmental expenditures by engaging in "public works."

Are these not all expressions of an underlying consciousness that our difficulty is one growing, not out of overproduction, but out of underconsumption, that there can be no real and general overproduction "until the last Hottentot lives on the scale of a multimillionaire."

If this is a correct analysis of the situation, it becomes clear that our troubles grow out of our common failure to go to the bottom of the subject, and the explanation of this failure lies in the fact that, when we get well started in our study, when we begin to question our axioms, our prejudices, our superstitions, we encounter the subject of money and prices, and there an inferiority complex takes possession of our minds. We remember the discredited money movements of the past, the "free-silver" agitation, the greenback campaign, the Jacksonian episode, and, as a result, it is considered distinctly bad form, or it was until recently, to question the gold standard, to ask what is meant by the expression "sound money." "Tinkering with the currency" is looked upon as a crime comparable with treason. Men could starve before we would try to understand deflation, reflation and inflation.

It is vastly important that we should see that a fall in the general level of prices is not a necessary consequence of overproduction, providing the supply of the means of spending (money) increases along with the supply of everything else. If the production of two commodities increases proportionately, and nothing transpires to affect the relative demand for them, must not then their relative market price remain the same? For example, if we double the supply of corn and also the supply of wheat, the value of corn relative to wheat is not thereby affected, although the price of both may fall relative to other things. It is exactly the same when you have money on the one hand, and commodities on the other. If everything increases in supply at once and the monetary supply keeps pace, increasing *pari passu* with trade, there can not result any fall in the general level of prices, no matter how large the general production becomes. When we remember that the law of demand and supply applies to money as it does to shoes or anything else, is it not clearly to be seen that a rise or a fall in the general level of prices, as distinguished from a change in the prices of individual commodities or groups of commodities, is solely a monetary phenomenon and not an indication either of general overproduction or of general underproduction?

The second current fallacy is the belief that prosperity can be attained by reducing production. This fallacy is evident when we realize that what one man produces furnishes the means to buy what the other man has produced. Hence, if one man reduces his production, the other can not sell his goods to him in such large volume. In other words, a decrease of production results in a reduction of employment and hence deepens the depression.

Clearly, maximum national well-being is a product of large net production plus a net surplus of imports over exports and of leisure to enjoy the resultant supply of goods and human satisfactions. Reducing or limiting production inevitably lowers the average well-being. We could all use more clothes, houses, food, autos, yachts, books, entertainment and a million other things, and we might well have much more of these things than we now have.

Merely putting more people to work, or paying more people a higher hourly wage, does not necessarily mean that there will result an increase of purchasing power, absurd as this statement may seem on casual consideration. It seems logical that, if one hires more men or pays his men more money, then there must result an increase of the total spending power. But that depends upon where the money to pay these men comes from. If it comes out of the employer's pocket or bank account, then it reduces his spending power just as much as it increases that of his employes. If any such apparent increase of spending power comes, by one route or another, out of existing money supplies, already in circulation and in use, then the process does not increase the total spending power. It simply transfers spending power from one individual or group to another, from one workman to another, from employers to employes.

Obviously there is a limit to such a procedure, unless profits are increased sufficiently to yield the larger wage payment. We can't forever keep taking water out of a vessel without putting more in. Furthermore, the net economic gain from merely transferring spending power is nil, howsoever valuable it may be as a social device to spread the good things of life.

In so far as any effort to raise wages without increasing production per man succeeds, it must inevitably result in an increase of manufacturing costs. It then follows that this must be offset by increasing the tariff to prevent foreign competition from getting all the business. This would reduce imports and consequently exports, because, in the long run, they must balance; and this would spell ruin to the farmer producing for export. The next step is to give the farmer a concealed dole, in the form of an artificial boost of the prices of the things he produces, this to be financed by increasing the tax on consumers and on industry, which means still higher costs of production.

Once launched on a series of these attempts of the economic snake to live on his own tail, there is bound to be less snake; if it goes on long enough, the snake will have eaten himself up completely.

It is necessary, if we are to understand clearly this matter of increasing purchasing power, that we examine each proposal to see whether it will really increase spending power or merely transfer it. Suppose we consider governmental expenditures for public works. If the money is borrowed by the Government through the sale of bonds to individuals, then it merely comes out of one account and goes into another, possibly in the same bank. No actual increase of spending power takes place.

An example may help to make this clear. If the Government sells a bond to A, he draws his cheque on the bank to pay for it. The bank then is forced to ask some borrower, B, to pay his loan in order that it may meet A's cheque, unless the Government deposits the cheque in the same bank. Clearly, neither A nor B can then spend the money. The spending power has been transferred to the Government.

Of course, if the bank goes to the Federal Reserve for the funds to meet A's cheque, then there is an actual increase of spending power or bank credit. But this same result follows when the Federal Reserve banks buy bonds on their own volition. There is no necessity for the Government to issue new bonds to enable them to do this.

Was not the refusal of President Hoover's advisers to see the monetary angle of the whole problem, or their reluctance or inability to follow its implications to a conclusion, the real cause of his failure to end the depression and of his resultant defeat? Did he not place reliance on the RFC and similar activities, which did not increase but merely transferred spending power, as the NRA is now doing? Did he not attempt artificially to control prices by operating on specific commodities, such as wheat, although in a less unsocial way than by destroying or dumping them? Did he not fail to assert society's mastery over this monetary Frankenstein monster, which alone determines the volume of purchasing power and hence is the only instrument that can control the price level and prevent booms and depressions?

PRAGMATICALLY, the non-monetary New Deal experiments, however well intended, have not worked. What would work?

Generally conceded, now, is the fundamental fact that the only cure for unemployment and depression is to increase spending power. There seems now to be no difference of opinion on this.

A related fact, not so generally recognized however, is that such increase of buying power can come in only three forms:

(1) Increased supplies of coin or currency in actual circulation

(2) Increased use of bank deposits subject to cheque

(3) Increased circulation of existing monetary supplies, that is, increased "velocity of circulation."

Therefore, it is clear that our efforts should be directed toward one or more of these three objectives.

In order to avoid confusion of thought due to this fact that both the money volume and the velocity of circulation of money are factors in the volume of spending power, I have ventured to coin a new term to express the concept of the total supply of money, bank cheques and other money-like instruments of payment, multiplied by the velocity of circulation thereof—to wit: "money-like volumocity."

For securing the essential increase of spending power or volumocity, there are devices of two kinds. One kind is aimed at the increase of borrowing from their banks by business men. They consist in: (1) Spreading reports or making announcements that the price level is going to rise. (2) Open market purchases by the Federal Reserve banks—not by member banks, whose purchases merely transfer holdings. Such Federal Reserve purchases tend to increase the member bank reserves; but they are not effective in producing an actual increase of volumocity except when the increased reserves are used by the member banks to increase their loans and investments. (3) Increased rediscounts by member banks, which are encouraged by reducing the Reserve banks' rediscount rates. (4) Increase of gold supplies through imports or production or the taking of gold out of "earmark" or out of more popular forms of hoarding. The results are identical with those following open market purchases. (5) Reducing the weight of gold in the dollar (which is the same as increasing the mint price of gold), as a means of stretching a given supply of reserve gold to enable it to support a larger volume of credit and currency. (6) Using another sort of metal to supplement gold in the reserves or in the circulating medium. This is effective only when it results in an actual increase of volumocity.

The other kind of devices is aimed more directly at the circulating medium. They consist in issuing legal tender money solely on the faith of the Government or other issuer. This is called Fiduciary Issue in England. It provides a real and actual increase of volumocity and it can be effected by issuing the notes in purchase of outstanding bonds, in payment for public works or of Government expenses, etc. In the same general category is the increase of national bank notes, Federal Reserve notes and Federal Reserve bank notes, although these devices are under banker control.

Among the devices for *limiting* or *decreasing* the volumocity are:

(1) Decreasing the volume of borrowing from their banks by business men by spreading reports or making announcement that the price level is going to fall. (2) The sale of securities by Federal Reserve banks. (3) Increasing the rediscount rate as a means of discouraging rediscounting by member banks and, hence, of limiting or reducing the volume of their loans to their customers. (4) Exporting gold, or otherwise reducing the gold supplies, such as "earmarking gold," circulating gold or gold certificates, taxing gold mining, etc. (5) Increasing the number of reserve cities, which has the effect of compelling the banks in those cities to carry larger reserve balances and hence to call loans. New reserve cities may be created by resolution of the Federal Reserve Board. (6) Calling the unpaid capital of Reserve banks. It is now only half paid up. (7) Increasing the legal minima of member bank reserve ratios. This would force the banks to call loans if their reserves were below the new minima. New legislation permits this to be done readily. (8) Calling

in Treasury balances in gold and hoarding it. (9) Retiring national bank notes, Federal Reserve notes, and Federal Reserve bank notes. (10) Increasing the weight of gold in the dollar, which would reduce the nominal gold reserves of the Federal Reserve banks. (11) Retiring United States notes. This can be done by issuing interest-bearing bonds in redemption thereof and by other means.

It will be noted that the devices for limiting and decreasing the volumocity, that is, for preventing inflation, are both more numerous and more effective and compelling in their effects than are those for expanding it. This is the answer to those who would tell us that, if we try to manage the monetary supply rationally and scientifically, we are sure to have such orgies of inflation as Germany experienced during and after the War.

Expectation of a rise or a fall in the price level is a matter of major importance in this problem of controlling the volumocity. If people know or expect that there is going to be a rise in the price level, they will not only spend what funds they have, which means an increase of the velocity, but they will go to their banks and borrow more funds to buy more goods; and the banks will then lend them the funds willingly. This means an increase in the volume of money and credit in use. The combined result in a positive increase in the volumocity.

On the other hand, if people think there is going to be a fall in the price level, they will not only be slow to pay out money to buy goods, but they will use it to pay off their loans at their banks, thus bringing about a decrease of both volume and velocity.

Confidence in the future of the price level is what people usually mean when they speak of the necessity that "confidence be restored." They do not mean confidence that the budget will be balanced or in the credit of the Government, or in the "soundness" of our money. They mean confidence that prices will not fall, or that they will rise. This confidence can be assured by means of a public announcement of the future price level by the authority having the power to determine it—which means the President, under existing law.

The problem of regulating the volumocity so as to secure for society the boon of a stable price level is thus seen to be, not a problem of economics, but of management, comparable to that involved in controlling a lake so as to keep its surface at a stable level, plus the problem of assuring the public as to what to expect in the way of a future price level. This latter part of the problem is solved, however, when the public is taken into the confidence of the monetary authorities and a definite future price level is publicly announced and the public is assured that the monetary powers will be used to attain that level and to stay there when it has been reached.

Such a public announcement by the President would be the best possible safeguard against inflation (or a rise of the price level above the desired and announced point), because, as that point is approached, everybody will know that the monetary powers will be used to stop it there. Hence, they will govern their own borrowing and lending accordingly, and thus assist in the process of stopping the rise. Also, with a definite and equitable price level set in advance, public opinion would surely support the monetary authority in the use of all its powers to stop it from rising farther.

The point at which the level of prices is to be stabilized is not nearly so important to society and to economic stability, however important it may be to individuals, as would be the definiteness given to the monetary policy and the assurance given to the business public by the announcement, if made by one having the authority to enforce it.

However, the level to which equity would dictate that the general average of prices should always be restored, after any departure therefrom, is the weighted average of the levels at which existing debts were contracted. This is the "level of maximum equity" because it is the level that would work the maximum equity between creditors and debtors and result in the minimum of injustice in the effort to right the wrongs already created by previous wobblings in the value of the monetary unit.

Its calculation is a purely administrative and comparatively simple task that offers little difficulty to those trained in such work, and for which all the necessary data are of record and available.

When the general level of prices continues for a considerable period at one stable height, then business hums under the universal impetus of profit-seeking and the general desire to increase earnings by increasing productivity.

This statement does not depend upon logic alone for its proof. It is supported by ample experience. A study by the International Labor Office covering over twenty countries confirmed it. It was proved beyond a doubt by the experience of the United States from 1922 to 1928, during which period Governor Strong, of the Federal Reserve Bank of New York, maintained the general level of prices on an even keel, by the use of only such of the devices mentioned above as were available to him. And an irrefutable demonstration of the practicability and effectiveness of the policy is provided by the success of Sweden during the past two years, where the monetary authorities have, deliberately, successfully and in accord with announced intention, utilized their powers to keep the price level stable.

These advantages might now be ours if the President or the Congress should issue instructions to the Federal Reserve and other monetary authorities to utilize their powers as described above, and now granted to the President under the Thomas amendment, to the end that the price level be restored to the "level of maximum equity" and there stabilized.

Clearly, the paramount duty of government is to see to it that the monetary machine is so managed that the general level of prices does not fluctuate, rather than to permit it to fluctuate and then attempt the wholly impossible task of locating the victims and trying to compensate them for the injustices and inefficiencies and hardships that result.

In short, that government is best that keeps the price level stable, because then it will have to govern least!

If we restore the average of prices to the level of maximum equity and keep it there by scientific monetary control, we shall have taken the first essential and the longest possible step in the direction of efficient economic planning. Without it, society seems lost in a mental quicksand and headed for economic suicide.

Retort to *The Fight Over Money*

BY RICHARD A. LESTER

Some comments, from the more conservative point of view, on Paul Ernest Anderson's article in last month's REVIEW

THE nature of money is probably least understood by those who have the most of it. We, as a people, have been accused of being money-mad. Certainly, judging from the crack-brained notions about money that one hears so frequently nowadays, some of us must be mad.

Who hasn't, at least twice a week, been treated to that mercantilistic fairy tale of the local shopkeeper to the effect that chain stores drain a community of its money? But where is there a village that shows signs of such currency starvation? One might just as well argue against buying automobiles because such purchases mean sending money outside the town—to Detroit. How much better to use horses which reproduce themselves and feed on local fodder! Think of how rich the town would be from the funds so saved!

Monetary truth, I realize, is stranger than monetary fiction. Gresham's law, that bad money drives out good money, must sound strange to both Biblical students and movie fans. I admit that our economists, with their abstruse explanations and Crusoe-Island illustrations, have been of little assistance to the bewildered layman in his search for monetary truth. But it doesn't help matters for journalists and fiction writers to go the professional economists one better, for them to offer a confused public pages of solemn nonsense and disproved or unproved notions. I refer particularly to Paul Ernest Anderson's article, *The Fight Over Money*, in the October issue of THE NORTH AMERICAN REVIEW, and I shall have occasion to refer to it more particularly in just a moment.

It is a platitude that a man must make money to be prosperous. But it is far from true that a country can become prosperous by making (printing) money. Neither is it true that the more money a country has, the wealthier it is. Germany learned this sad lesson shortly after the War when a billion marks bought but a box of matches.

During a depression each person feels that what he needs is more money. Naturally, he assumes that this is what the country as a whole needs, whereas, as a matter of fact, if both the amount of money and all prices should double overnight, he would be no better off than he was the evening before, even though he had twice as much money in his pants' pockets and the dollar value of his assets had doubled. Wealth is a