LV & Cap. formation

"Income creating" spending isn't really output creating. If supply inelastic is just inflationary.

Supply of land is a flow. Rent payments do not Δ it.

Man may bring more land into his control by migrating, but paying rent isn't the same thing.

Dilemma of fiscal policy, how employ more w/o inflating. Put land to work by taxing it, no Δ demand necy. or desirable.

Pregnant

Money spent for rent puts no one to work.
Then if landlord buys land, money doesn't get back into cycle. Is siphoned off best good.

In U.S., spending more $ for rent raises rents, but that is not end, bec. our culture permits migration, spreading over more land, & thus $ l.v. opens new invest. opps., big cycle.
In feudal countries, hi l.v. have no such effect, so land is really limited, inelastic, & rent payments are leakages in cycle.

Land titles compete most w. durable cap., as alternative. Appeal to those who don't need funds to complement their labor.

Pvt. ec. biased vs. durable invmts:

a, Land titles compete
b, Prop. tax hits
c, Govt. compn. threatens.

This keeps cap. stock flexible, good. But tax-free instns. move into vac'd, esply govt. Freeze cap. thus.

And it lowers $ cap. stock.

Δ Land Value & cap. fmtn.

As l.v. rises under old bldg. it devalues bldg., thus destroys capital.

Owner no longer need put sums in sinking fund to replace bldg. as it depreci. The l.v. has replaced it.

Return is all income now, higher % goes for cons.

[and GNP is an accurate msre of N?]

FEDERAL RESERVE BANK OF CHICAGO
CHICAGO 90

September 11, 1961

Professor Mason Gaffney
University of Missouri
Department of Agricultural Economics
Columbia, Missouri

Dear Professor Gaffney:

The source of the comparison of capital gains with farm income was an article by Ernest Grove "Farm Capital Gains--A Supplement to Farm Income?" which appeared in Agricultural Economic Research in April 1960.

I hope this will serve your needs. I found it to be a most interesting and thoughtful discussion.

Very truly yours,

John M. Wetmore

John M. Wetmore
Agricultural Economist

Works both ways:

After big Δ of cap. formn, the cap. also subs. for land as an asset, reduces desire to hold land, contributes to collapse of l.v.

2/27/57

Dear Mase:

I think you will be interested in "Economic Growth and Distribution in the Middle East," by W.O. Thweatt, appearing in the January American Journal.

Regards.

Bob

It is good, on big landlords & cap fmtn — they hinder it.



THIS SIDE OF CARD IS FOR ADDRESS

Mr. Mason Gaffney
Dept. of Economics
North Carolina State College
Raleigh, N.C.

Leg.

"cap. formn. in Underdevd. Countries."

N. Rosenberg.

AER 9-60

Some on land purchases.

Cap. fmtn

Buyg l.v. is just xfr? Not quite, bcs l.v. change. After Δl.v., investor buys land, at higher price, but seller regards ΔP as income, consumes most of it. Thus cap. fmtn is lost. After -ΔP, probly v.v. .... thus l.v. → Δ cap. fmtn.

When a new privilege is created & sold, buyer is not creatg cap., & seller probly isn't -- is just realizg income from labor of creating privilege. He may regard it as a xfr at time of sale, but then has bn income before sale, same effect earlier. Destroying privileges, ~~etc~~ v.v.

Thus pvt. land income sets floor of zero under i.r.; but if gnrl Δ is expected, sets higher floor. A 2% annual antic. Δ of rents sets floor of 2%.

Has it any tendency to push up whole structure of i.r.?

If Δ liq. pref. can be said to Δ i.r., why not Δ land pref.? Either is "just a xfr," but not nec. ∴ w/o effect. Higher l.r. create Δ liq. pref., for one thing. They ΔT w/o ΔY, by interposing more xactions between Y-creating ones.

The result of antic. Δ land incomes is like Δ liq. pref., to force up whole structure of i.r.

a) No one will invest in anything but land until mgnl rates are =. If antic. 2% annual Δ rent, sets floor under all i.r. since at $P = \infty$ is still a 2% yield

The gnrl assumption of those who say buyg land is just a xfr, is that amt of spending remains unaffected. But 1) No. of nec. xfrs is Δd, or at least their value rises, absorbing more funds from Y-creation; 2) Liq. pref. rises, to force Δ l xfrs. 3) Consumption Δs etc.

So Y falls, & takes part of adjustment, just as when you Δ liq. pref. But in cycle.

Higher i.r. mean some mgnl. borrowers bow out. Total borrowg declines. Suppose supply of loanable funds did not decline? Then the surplus wd. go to bid up land price some more --- up w/o limit, if annual Δ 2% is assumed.

Importance of this:

1. When mkt antic. Δ ground rent, → Δ i.r. !!
2. Just as antic Δ rent keeps i.r. > % increase, so antic. const. rent keeps i.r. above zero. And same reasoning suggests l.v.t. wd. lower i.r. by Δ supply of funds. But wd. also Δ demand for funds

I overlooked one vital point. As l.v. rise, the capital poured into buying land does indeed disappear in part. Bes as values rise they absorb more. Seller gets more, but only part is xfr. All over orig. price is income to seller. Thus it is that real invmt. is reduced.

Also, N.I. analysts get impression people will save less from given Y than they really will — they think the people think their Ys are higher than data show. Or does N.I. now include cap. gains - BW says so ~~ob.dict.~~ maybe wrongly.

Thus N.I. analysts underest. their capacity to hoard money when inc. drops, think we can have no recession. But when l.v. go down & m. inc. falls simul ... look out!!!

Now all borrowers accustomed to borrowing < 2% wd. not be able to. Assuming inelastic demand they wd. then borrow at 3%, push up the 3% borrowers to 4%, etc. If demand fairly inelastic to i.r., & supply also, this outside disturbance cd. move i.r. quite a bit — but it wdn't matter much, either. If demand elastic, as it is, reduce invmt in durables. But this doubly reinforces tendency to invest in land subs, create cycle.

Much funds going into mortgages via Ins. Cos., Mutual Savgs Bks, Bldg & Loan, are to buy land. Are probly counted as inc. creating, but really aren't. Part are for new land, & part for Δ l.v. caused by p.w. invmts already counted, hence to count again as Δ y-creatg is double-countg.) Thus Δg share of invmt funds are used to buy land, but aren't recognized by ~~its~~ N.I. accts as xfrs.

It is not so much that those with money wd. buy land, but lend it to land buyers whose bidding for funds wd. take all loans away from borrowers < 2%.

On upswing, antic. ΔP, & higher antic. yields, keep up Veloc., masking Δ liq. pref. At crest, powerful reverse forces take over. -ΔV. also, land is more liquid in a rising market.

If mkt. antic. Δ ground rent @ 2%, then this sets a sort of floor under i.r. But don't be carried away by ∞. In fact rents are not quite perpetuities — even land titles are sometimes confiscated. So if saving persisted, and demand for loans fell, land prices wd. simply move up to some finite high level at which the mkt. wd. equate l.v. returns. If there were a chronic surplus of loanable funds, l.v. wd. go sky-hi, and returns wd. sink below 2% in some meaningful sense. Say at 2%, $V \neq \infty$, but $V = \frac{1+i}{i-d}\left[1-(1+d)^n(1+i)^{-n}\right]$

Let $d = 2\%$, but call it g, growth

Let $i = 1\%$

$n = 200$

$$V = \frac{1.01}{-.01}\left[1-\left(\frac{1.02}{1.01}\right)^{200}\right] = +101\left[\frac{49}{7}-1\right] = 606$$

As a check, $V = 1 + r + r^2 \ldots$ etc $\ldots + r^{200}$.

$$r = \frac{1+g}{1+i} = \frac{1.02}{1.01} = \frac{1.01+.01}{1.01} = 1 + \frac{.01}{1.01}$$

$$\Sigma = \frac{1-r^{200}}{1-r} = \frac{1-7}{1-1-\frac{.01}{1.01}} = \frac{6\times 1.01}{.01} = 606$$

Now expectations of events after 200 yrs will certainly vary highly. Some people will not sell & wd. not consider selling at finite prices, or at least at mkt prices. People also differ in attitudes toward leaving assets to heirs. Those who want to found permanent family dynasties will not sell — & will also value an asset that can be tied up so as not to be spendthrifted.

But some land will come on mkt bec some holders will not put much value on expectations after 200 yrs. Thus a price of land established $< \infty$.

Now whether this stops a lender from lending elsewhere at $< 2\%$ depends on his expectations re future land income. This changes my initial assumption. If universally all expect 2% annual Δ grnd rent, is a definite floor under i.r. Then if are surplus savings they never get into Y-creatg invmts but go to buy land, sellers buy more land, etc. ad inf.

In practice however there are several adjustments. New kinds of invmt. opps open, to sub. for land, & this puts ceiling on land prices too. Savings decline.

Conceivably, no land cd. ever come on mkt. Then other savers wd. have to accept $< 2\%$, if nec. But this is just a remote & unreal "conceivability".

Upshot is, antic. Δ grnd rents do tend push up i.r. If they had no effect on s & d of loanable funds for Y-creating, the effect wd. be temporary, largely, price of land wd. rise to equate returns. ~~land saving invmt wd be promoted.~~ But they do reduce supply of loanable funds by Δg xfrs, Δg liq. pref., $-\Delta g$ saving; & they alter character of demand.

T. S. Adams, while arguing vs. Lvt., introduces proposn that taxes on capital lower m.e.c. (maybe he does, wd. have to check it)

But I wonder re passing on the tax -- not to "consumers", for in gnrl they ≡ producers. But to complements.

Cap. goes out of longest-term invmts (to extent they aren't taken over by govt.)(tax-free). where int. is large share of TC, & so demand elasticity for cap. is very interest sensitive. It goes into short term invmts. But so do its complements! How now do we know in result that investor will finally bear tax?

Bes. higher Turnover. Cap. not locked up so long, forever needing reinvestment. This presses on others, reduces investrs' relative bgng position.

Land also is released sooner, maybe, but dubious if so at all, & if so at all, not as much as for capl. Bes. tendency is to build so as to get quick depreciation, but leave a shell to earn some income. You get most of yr. money back soon, but leave the Land in. Longer probly than before, to get lower mean taxable value over time. So you spread cap. out over more land, (next p.) [Then use the m to dev. more land, so ultimately you do get more land. And while getting it, get hi yields to invmts that make it. But higher land prices do not ff. from A taxes on cap. alone, so irrelevant]

and thus ultimately bring in more.

Thus taxes on improvements ultimately reduce land rents per acre. But, like free xptn, they do not necly do this to the benefit of others. They sterilize the better lands for a while & maybe the lower rents just reflect reduced efficiency.

As to ec. stability, if you hv. X million lots coming on mkt for renewal once every ten yrs, & trade that for 2X million every 20 yrs, you're dealing w. bigger body of lots — so?

On 10-yr turnover, 10% lots renewed each yr. On a 100 yr turnover, just 1%. The larger inventory means any given yr. can be easily glutted or starved by small changes. A slight accelerating force cd. throw 5% on mkt some yr, swamp it; a ½%, drought it.

(NB, re cap. fmtn, hi l.v. show up not just in hi unit values but spread'g them over more units)

They say when buy land, whether is an invmt. depends on what seller ~~did w.~~ does w. money.

How about depending on what he did w. money before. He never entered production process.

[Neutral assumption shd. be, when dg. buyg land vs. buying stores, seller does same thing in either case, + thus isolate effects of the one actn. If buy stores, you add one to no. of + more holding produced stores]

Add to that, seller of stores is more likely to reinvest; ~~than~~ seller of land, to consume, or buy more land.

When buy stored produce, you create some income, for the residually rewarded storeholder. As well as liquidating his invmt. of course.

Seller disinvests, while land seller doesn't. (Buyer invests, while land buyer doesn't)

Buying bldg, you commence carrying something that was produced. Thus carry part of real productive burden

Looking future, you will liquidate this & reinvest. So is not just a qn. of what seller will do next, also buyer. Land buyer will never liquidate & reinvest principal

By buying from a real investor, a storeholder, instead of a landholder, you make his past invmt. more successful & encourage more. Make a niche for more. Either you empty a warehouse or you build one. And hence $\uparrow$ returns.

By lowering i.r. ... raising price of stores — you encourage others to hang onto ~~cap.~~ stores longer, go into more durable invmts.

Might expound in 3 parts: looking to past, present, future.

Past — — land seller never invented

Present — no matter what seller does w. money (~~and~~ or assume no difference. But there remains a diff. in what buyer did.)

Future — store seller more likely to reinvest in stores.

Choice is between buying land vs. investing by hiring inputs. In any pd. when buy land, all the moneys so diverted rep. a net loss of investment

--- w. multiple effect on N.I.

Buying land, maybe in next pd., will be more invmt., from seller or & less consn., from hired inputs. Thus cap. formtn. may balance out, but real output will be lower.

IN PRESS •••• brief remarks on new books from JOHN WILEY & SONS, Inc. ••••

Keirstead:
CAPITAL INTEREST AND PROFITS

What is capital? Is it a fund of productive power in the abstract? Is it a fund of money? What is the essential nature of capital accumulation and capital formation?

One answer to these questions can be found in B. S. Keirstead's new book, CAPITAL INTEREST AND PROFITS. Now teaching at the University of Toronto, Professor Keirstead examines the process of how new capital is formed and rewarded in a progressive society.

To quote from the book -- "This process involves social abstinence in varying degrees, depending upon the richness of the society. For a conventional, non-progressive society the initiation of new capital formation requires some social shock. If the society is a poor one, the social abstinence which must exist over some period of time will have to be enforced by some authority. In richer societies the abstinence may be voluntary, and may not be severely felt by the members of the community. "

On both logical and empirical grounds, Professor Keirstead sets forth his reasons for rejecting the marginal productivity theory of distribution and the time-preference theory of interest.

Instead, he proposes an eclectic theory of interest which has a place both for investors' expectations and the policy decisions of the monetary and fiscal authorities. This theory of interest establishes the important differences between interest, profits and the returns to stock.

CAPITAL INTEREST AND PROFITS should be of immense interest to all economists. Published this month, it contains 180 pages and is priced at $4.00. A thirty-day examination copy will be sent to you on request.

Yours sincerely,

William Bennett

William Bennett
JOHN WILEY & SONS, Inc.
440 Fourth Avenue
New York 16, N. Y.

File: Cap. gains?
Write for study cited

Federal Reserve Bank of Chicago - -

Agricultural Letter

June 10, 1960

Number 562

FARM REAL ESTATE VALUES, according to the U. S. Department of Agriculture, increased 3 per cent in the year ended March 1, 1960, compared with increases of 6 to 8 per cent in each of the three preceding years. While all regions recorded smaller changes the past year, the slowdown was most noticeable in the Corn Belt, Lake and Northern Plains States. Illinois was the only state in which no increase was reported. Wisconsin land values were up 1 per cent; Indiana and Michigan, up 2 per cent; and Iowa, up 3 per cent.

In the four months from November 1, 1959, to March 1, 1960, values changed 1 per cent or less in thirty states. In the Seventh District, Wisconsin values increased 1 per cent, while Illinois and Iowa values declined 1 per cent.

Future trends of land values, in the opinion of reporters, were more strongly weighted toward little change or a decline than last fall. The most notable change was in the Corn Belt, where about one-third of the reporters thought market values would decline in the next six months. Demand for farm land last winter and early spring appeared to be noticeably lower in the Corn Belt, and the rate of sales this spring was also down in this area.

The paradox of the inverse relation between land values and farm income continues, even with the apparent leveling off of land values. While net farm income in 1959 was down substantially from 1958, it was not greatly different from the levels of 1955, 1956 and 1957. Yet, in each of these years, farm land values have increased so that the return on the current market value of farm land and buildings dropped to 3 per cent in 1959, compared with an average of over 4 per cent from 1955 through 1957 and more than 8 per cent in 1950 and 1951.

The common explanations given for the continued rise in land values have included the pressure of urban areas on surrounding farm land and heavy demand for land to increase the size of existing farm units. A further reason has been the purchase of farm land as an "inflation hedge," with purchasers expecting the rise in value to more than compensate for the low returns on capital investment from farm operations alone.

In a recent study by the U. S. Department of Agriculture, the average capital gain per farm would have amounted to 43 per cent of the average net income of farm operators per farm if farmers had received as income the rise in values in the period 1940 through 1959. While for most farmers these capital gains represent "paper profits" which could disappear in short order if values declined, in only three years of this period were there declines in capital value.

Capital gains in the past have not been included in figures on national income or farm income because nothing has been added to the total amount of commodities and services available to the nation. Instead, higher values have been placed on existing capital items, in this case farm land and buildings. On the other hand, the individual who benefits from capital gains has just as much claim on the current flow of commodities and services as anyone. For this reason, capital gains and losses should be included in calculating income to the individual. In addition, the special tax provision for capital gains makes this type of income much more preferable to people in the higher income brackets. Furthermore, when comparisons are made between farm income and nonfarm income, the importance of including capital gains as a part of income becomes even greater.

Farm capital gains in relation to farm income

Year	Average net income of farm operators 1/	Average capital gain or loss (-)	
		Amount	Per cent of income
	per farm		
1940	$ 720	$ 125	17
1941	1,044	850	81
1942	1,600	1,300	81
1943	1,942	1,300	67
1944	1,967	1,200	61
1945	2,080	1,150	55
1946	2,574	1,725	67
1947	2,648	1,775	67
1948	3,065	150	5
1949	2,259	- 650	- 29
1950	2,479	2,850	115
1951	2,951	2,200	75
1952	2,829	-1,100	- 39
1953	2,502	-1,250	- 50
1954	2,440	600	25
1955	2,313	400	17
1956	2,338	1,700	73
1957	2,426	1,900	78
1958	2,990	2,750	92
1959p	2,547	875	34
Average 1940-59	2,286	993	43

1/ Includes the value of changes in farm inventories.
p Preliminary.

Research Department

Accelerated Economic Growth

A KEY TO THE AMERICAN FUTURE

As outlined in a speech to the
Governor's Conference on Automation,
Cooperstown, New York, on June 1, 1960

GOV. NELSON A. ROCKEFELLER

STATE OF NEW YORK

NOTE: On June 1, 1960, at the Governor's Conference on Automation held at Cooperstown, New York, Governor Nelson A. Rockefeller of New York delivered the third of a series of addresses on major issues confronting the people of the United States. This is the text of that address, which deals with the need for accelerated economic growth in the United States.

ACCELERATED ECONOMIC GROWTH

A key to the American future

Throughout the Thursday and Friday sessions of this Conference you will be dealing in depth with problems related to automation. It is my purpose to talk to you tonight about economic growth.

I chose this topic because I am convinced that only an environment of vigorous and sustained economic growth can provide a framework for dealing in a really satisfactory fashion with the important human problem of job displacement caused by increasing automation.

I chose it because I believe that rapid economic growth is the key to more jobs, better jobs and better-paying jobs necessary to provide higher living standards for a rapidly expanding work force.

I chose it because economic growth is a prime necessity if this Nation is to discharge its formidable responsibilities and meet its rapidly-mounting needs in such fields as education, public health, national defense and international economic cooperation in the decade ahead.

Finally, I elected to speak about economic growth as an introduction to this conference because I believe that automation, properly and broadly conceived, is one of the more important and necessary instruments through which a more rapid rate of growth may be achieved.

I—The meaning of automation

Automation essentially is a complex of measures -- organizational procedures, techniques and equipment -- that combine to augment the output of a given worker in a given amount of time.

There is nothing mystical about it. The building of the first windmill, the invention of the first printing press, automatic loom, steam engine or typewriter, the setting up of the first assembly line in production -- all of these were steps in the direction of automation.

The most highly mechanized of modern oil refineries, installations of automatic machine tools in metal manufacturing, or the use of huge data-sorting machines and electronic computers in government and business establishments are simply further steps in the same direction.

In short, automation is an essential part of progress -- increasing productivity and producing higher earnings for the workers.

The introduction of new and better machines and methods underlies the tremendous rise in our standard of living.

At the same time, modern technological breakthroughs have opened up possibilities for introducing the techniques and tools of automation upon a tempo and scale that dwarfs past performances in this direction.

This has raised the spectre of possible job displacement on a large scale. But since automation requires very heavy capital expenditures, the cost of providing the equipment upon which it

depends is likely to limit the speed and the extent of its adoption. In a stagnant, slow-growth economy, there would be room for genuine concern over the displacement of men by machines. I do not believe we need fear such a situation in any general national sense in the period ahead. However, I feel very strongly we must be sure that other opportunities are available to the individuals affected by automation.

We should welcome automation because our problem over the coming decade promises to be not one of creating enough jobs but one of creating enough production.

This nation faces vast and expanding challenges and opportunities at home and abroad. To measure up to the future, this nation needs to make sure that everyone who wants work has the opportunity of employment in a job that gives the fullest possible scope to his abilities and that provides the most modern equipment and methods for all workers.

In that manner we will at the same time accelerate our rate of economic advance and provide the scale of production needed to meet our national objectives.

I can understand and sympathize with the deeply ingrained fear of massive unemployment that is a heritage of the depression thirties. But I am convinced that many of the ideas carried over from this traumatic experience have no real application to the problems we must face in the nineteen sixties.

Such historic attitudes are likely to hinder rather than help us. Current and prospective problems promise to be of such radically different type and dimension that the always-relevant consideration of handling instances of employment displacement in a humane fashion calls for a completely new orientation in our thinking and approach.

It is within this reference framework that I want to talk to you about economic growth over the next ten years.

I shall set forth our past growth record, our future needs, the inadequacy of recent growth trends to meet these needs -- and finally I shall give some indication of how much additional growth is required to do what needs doing.

I shall then examine what forces and measures can be mustered to achieve that growth -- without distorting our system of private initiative that has given us a long-term record of dynamic economic growth unmatched by any other major nation.

The task, in short, is to accelerate our rate of economic advance without inflation and to do so within the framework of our existing system of initiative and enterprise -- with government action in a complementary and never a dominating role.

I am confident that we can discharge this task if we as a nation are willing to work for it and adopt the kind of policies that will bring it about.

The times call for hard work and hard choices -- qualities that are part of the American heritage.

II—The United States' record of economic growth

The best available estimates of the long-term growth record of the United States economy from 1839 to 1959 show a rising trend in our Gross National Product -- the value of the total output of goods and services in constant prices -- amounting to 3.7% annually. This has provided a doubling of real output every 19 years. It is a prouder record than can be shown by any other national economy over a comparable span of time.

This long-term growth has been far from regular. From 1869 to 1930, the long-term trend was bettered slightly, averaging about 3.75% on an annual basis. For the depression decade of the 1930's as a whole, there was no growth in per capita output.

An unprecedentedly severe decline from 1929-33 was only partially recouped by a sharp rise from 1933-37, with some subsequent slackening off until the outbreak of World War II. Not until well into 1940 did we regain the level of per capita output that had been reached in 1929.

During the war, under the pressing stimulus for the full mobilization of all our resources, the high unemployment that persisted throughout the 30's was wiped out, even though work hours were lengthened. There was a great spurt in our economic growth, which showed average annual increases of about 10%.

Under the impetus of a national emergency, we increased our production more than 50% in 4 years -- proof that the American economy can respond superbly to challenge.

For the post-war period, from the 1947 level to the expectable Gross National Product for 1960, the annual rate of growth has amounted to almost 4%. Why, it may fairly be queried, isn't this good enough to meet the problems and needs of our nation at home and abroad?

Many thoughtful citizens have suggested that we have been placing too much emphasis upon material progress goals. They contend that these are not the true measure of a given civilization's stature. Some of them have held that, in an "affluent society" such as ours, it is fitting that we should concentrate less upon providing for the material needs and comforts of life and should give greater attention to those things that promote spiritual and cultural enhancement of our citizens as a whole.

I recognize clearly the need for giving weight to this claim, but I am profoundly convinced that the two sets of values are not conflicting alternatives.

At the same time I believe that vigorous and sustained economic growth is one of the requisites -- though certainly not the only one -- for building a society capable of discharging the extraordinarily heavy burden of social responsibilities in prospect for the years ahead.

We must be equally concerned about getting greater growth and using its proceeds wisely.

III—An appraisal of America's needs: 1960-1970

It seems likely that the Gross National Product for 1960 will be around $510 billion, or about $2,830 per capita for a population of 180 million.

If our recent growth rate of about 4% per year is sustained for the period, the GNP in 1970 would be around 48% higher, or about $755 billion.

But our population trend is on the rise also. By conservative estimate, our population in 1970 will approximate 214 million. This would make per capita GNP some $3,530 in 1970. Thus the gain that really counts -- the increase in the output per person -- would be only about 25% for the 10-year period.

This would be a most creditable growth record as measured by the nation's past accomplishments. But it would not suffice to meet the great challenges we face in such fashion that we and the world could look to the future with hope and confidence that it can be an era of opportunity and fulfillment of our ultimate objectives.

Our production is divided among a number of important uses. At present, about 20% goes to government at all levels, 16% is plowed back into private investment to support the growth in total production and 64% is spent on consumer goods and services.

There is never enough to meet all the needs in any economy. No nation has ever achieved the millenium under which all needs were satisfied. Thus every society faces a problem of choice among competing ends, since every society faces the fact that it is impossible to divide up more than is produced.

Yet we stand at a time in the history of the nation and the world when compelling needs make this problem of choice appear impossibly difficult under a 4% growth rate.

Balanced budgets on a pay-as-you-go basis to prevent inflation have become major objectives in this country. Therefore, the

choice is between taking a larger percentage of GNP, through higher taxes, for such government services as education, housing, and national security, or increasing the GNP at a more rapid rate so that the amount of the 20% taken by government will be sufficient. No one wants to see higher taxes.

I believe there are two compelling reasons to work aggressively and imaginatively to increase our rate of economic advance:

First, a 4% growth rate would not be sufficient to accommodate the real needs of the American people for rising living standards, better housing and better cities, improved educational opportunities, national security in an uncertain world, and improved individual security and job opportunities.

Second, a 4% growth rate is no longer adequate in the modern world to assure the long-term maintenance of our position as the world's leading and most dynamic economy.

A faster rate of economic advance would not eliminate the problem of making hard choices among competing claims on the national production. But it might serve to make the process of choice one that could be carried out by a democratic society in an atmosphere of progress towards the manifold aims such a society pursues -- instead of an atmosphere of frustration and conflict.

Perhaps I can make the problem more concrete by citing briefly some of the demands that are pressing on the economy:

1. It is our declared national policy to provide job opportunities for all Americans who are able and willing to work. In the decade of the '60's, our population of working age will be increasing at a radically faster pace than at any time in recent history. This factor will of itself contribute toward a faster rate of production output. But unless we step up our growth rate, it could result in the humanly unacceptable and wasteful alternative of increasing unemployment or underemployment. Accelerated growth in output is therefore a national imperative.

2. In addition to jobs, individual Americans want progressive betterment of their lives, a more rapid rise in their living standards. In the post-war period, wages have been increasing by an average of about 5.5% each year -- while output per man-hour has increased by only 3% a year. As an outgrowth of this, prices have risen an average of 2.5% each year with the result that they have cut into money wage increases by 40%. Therefore, there is obvious need to increase production efficiency to make feasible the present expectations for improved living standards.

3. National security expenditures need to be increased. Even when the early phases of a disarmament program are achieved, it will require increased expenditures because of the initially high cost of developing adequate inspection facilities. In view of continuing threats to the peace of the world, there can be little doubt that federal expenditures over the next decade will increase at a faster rate than can be provided by the government's proportionate share of a 48% growth in Gross National Product during that period. In addition there is the inevitable need for major new expenditures for adequate civilian defense protection. Our combined national security expenditures for domestic and foreign programs currently account for more than 50% of combined federal, state and local expenditures for goods and services. Of the various studies of prospective needs in this field, most of the estimates that have taken into account the contingency of mounting cold-war tensions have envisaged step-ups amounting to at least 5% or 6% per year over a sustained period.

4. Other government expenditures need to be increased. We have fallen behind in providing the public assets needed to support a growing economy and a growing population.

The great bulk of government expenditures for goods and services, other than in the national security field, is in the state and local jurisdiction. State and local expenditures have increased by about 70% on a constant price basis over the past 10 years.

Careful studies of nation-wide requirements for education and health programs and for public construction of school and hospital buildings, of highways, water supply and control systems, for sewage disposal, conservation and recreation facilities indicate the need for a doubling of budgets -- or more -- over a 10-year period.

When all these needs are added up, they exceed by a wide margin what we will produce under a 4% growth rate. Clearly, something would have to give.

If we were to meet all public spending needs without a more rapid growth rate, we would have to increase tax rates substantially. And by thus diverting a higher percentage of the GNP into public use, we would thereby cut the returns that the people could expect to get from the private sector of the economy.

I refuse to accept this prospect. I believe we have an alternative. We can accept the challenges and take the necessary steps to accelerate our economic growth.

So much for meeting our future needs. Let us turn now to the second compelling reason for accelerating our economic growth -- the competition that now is being offered us by other economies.

We must face the fact that the Soviet economy has been growing recently at a faster rate than ours. The Soviet economic thrust is being used as a weapon, along with the threat to use military force and the use of the political instrument of subversion.

Although the U. S. S. R.'s claims about the tempo of its economic progress are generally exaggerated, after all due allowance for overstatement is made the sober evidence emerges that her post-war growth trend has been at about a 6% annual rate as against 4% for us.

If we must admit that the Soviet Union has been maintaining a higher growth rate than ours, it certainly becomes harder to combat Soviet propaganda. It becomes more understandable that less developed nations would be impressed by Soviet claims that the Soviet system is better for promoting the economic growth these nations seek. On a selective basis, at least, the Soviet economy already is large and versatile enough to compete in trade and with aid that promises to forward her strategic aims.

We must face in addition the less-advertised fact that a variety of non-Communist nations also have been able to achieve post-war growth rates higher than ours -- and in some cases higher than that of the Soviet Union.

From 1950 to 1957, Japan's economy grew by almost 8.5% a year, West Germany's economy by 8% and Italy, France, the Netherlands, Mexico and Canada all grew in the 4.5 and 5.5% range.

Most of these countries mobilized larger shares of their Gross National Products in the form of capital investment than we did, and a number considerably more. Thus there is evidence that free economies which set out to promote growth by encouraging modernization and enterprise can achieve rates of economic advance that outstrip the Soviet record.

On the basis of the 1958-59 record, there has been considerable concern over the foreign trade position of the United States. Imports have been rising and exports lagging to a degree that would raise serious balance-of-payments problems as well as national economic and social problems, if long continued. A query has been raised as to whether or not the United States might not be "pricing itself out of the world market."

More time and study are needed to supply a definitive answer. There is considerable evidence, however, that the sudden deterioration in our foreign trade position cannot be accounted for by steeper wage increases or more price inflation here than abroad. In some fields, at least, there is disturbingly convincing evidence that our relative competitive position is being eroded. Some of our products are being outsold abroad and even in our home market by the products of other nations that are investing and growing faster than we are -- and therefore are achieving greater production efficiency and lower costs.

These nations are catching up with us by moving to large-scale production in many fields, by providing new, and modern and automated machinery and technology through investing at a faster rate than we are.

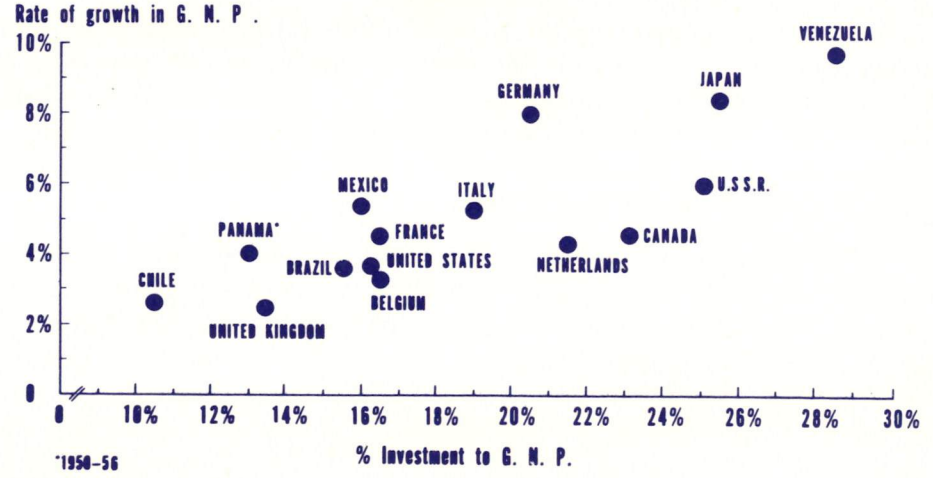
If they can match our man-hour productivity at lower wage scales, it is clear that we shall not remain competitive while retaining our much higher wage differentials.

The record shows a close relationship between rates of growth and the amount of total GNP mobilized in the form of capital investment.

I already have alluded to this, but now I want to show you a chart that dramatizes the important degree to which high investment and rapid economic growth go hand in hand.

HIGH INVESTMENT AND RAPID ECONOMIC GROWTH GO HAND IN HAND

1950-57



From this chart, you will see that the great majority of countries that grew substantially faster than the United States put substantially more into capital investment than we did.

Most of those that put as much as 20 to 30% of GNP into capital investment showed annual growth rates of between 6 and 10%.

This is a matter that deserves our most careful attention, and surely it is well within the agenda of this conference. For it certainly would do nothing to improve our competitive stature if we were to put hobbles on the pace of our technological advance.

The shocking fact is that over a period of 50 years, this nation's stock of plant and equipment upon which its output depends has been progressively growing older.

While others have been modernizing, we have been producing with facilities that each year are about three-tenths of one percent less modern on average than in previous years. I think it is incumbent upon us to reverse this trend. For if it is continued, those who really are modernizing their facilities are bound to outstrip us.

It is not good enough for the United States to have a second-rate performance record -- not if it expects to remain a first-rate nation.

IV—The prospects for growth

If we grant that more growth would be desirable, what are our chances for achieving it and how can it be done?

I am fully aware of the degree of suspicion that attaches to anyone who champions a 5% or a 6% growth goal, for there are those who look on this as "pie in the sky." Part of this skepticism, I am sure, derives from the fact that the advocates of faster growth often have been persons with no real belief that the institutions of private enterprise could be depended upon to produce it. Hence their advocacy was accompanied by proposals for central planning implemented by government interventions and controls. These advocates favor fiscal and monetary policies of a type that, historically, have created economic distortions and fed inflation -- demonstrably retarding rather than promoting growth in every free country in which they have been tried.

I would therefore firmly disassociate myself from those who argue that massive government spending, creeping inflation and far-reaching government controls provide the only route toward accelerated economic growth.

I am talking about growth that I feel sure is obtainable within the terms of reference of our proven system.

I believe we can grow faster and do so without inflation and without a spreading network of government controls. I have full confidence that America has the ability to achieve the goals it pursues. I have full confidence that America has the resolution to support the policies and make the hard choices essential for more rapid economic progress.

As one reason for my confidence, I again would point out that a number of free nations presently are growing faster than we are.

Western Germany is an outstanding example. I believe it significant that the West Germans have achieved and are sustaining their drive precisely by moving closer to the kind of economic system under which the American economy has prospered.

More basically, my confidence stems from an analysis of the anatomies of our past and future growth trends.

There are a number of factors here that will be working with us to promote faster growth in the 1960's than we have sustained in the past. There are a number of other factors that can be made to work in the same direction if we make the right choices.

Over the post-war period, U. S. productivity as measured by output per man-hour increased by 3% a year. The work force increase averaged 1.4% a year. That should have given us a GNP growth rate of 4.4%. But it did not. Work hours on average declined .6% each year, so that our GNP increase averaged only 3.8%.

It is clear that in this period, as we have been doing with regularity over at least 50 years (World War II excepted), we chose to forego an important part of the increased product we could have obtained in order to achieve increased leisure. We did this by shortening the work week and increasing vacation time. This has been a genuine social gain. It represents a valid and defensible choice. But it is a choice.

Obviously we could not go on indefinitely cutting down work hours at the rate of about $12\frac{1}{2}$ hours per year without reaching a point of diminishing returns.

If there were a sufficiently broad acceptance of national purpose, a full realization of the seriousness of the challenges we face, I think that the American public might agree on a moratorium on increased leisure for a period -- or at least to temper appreciably the downtrend that has prevailed.

One important plus factor for the growth trend of the 60's is that the work force will be growing at an appreciably higher rate. This is because the sharply stepped-up birthrates of the war period produced a population bulge. Therefore, the average annual work force increase in the current decade will be about 1.8% instead of 1.4% as in the past. This automatic factor alone would make possible a 4.8% annual increase in GNP -- even though we did nothing to accelerate the 3% annual increase in productivity -- so long as the work hours of those employed were held constant. With work hours shortened .6%, the growth rate still should be 4.2% on the labor factor alone.

But that comes far from exhausting the potentials for achieving a higher growth rate -- once we have set our sights upon this as a primary aim. There are many ways in which the 3% trend of man-hour productivity might be increased -- and here we come to the heart of the matter:

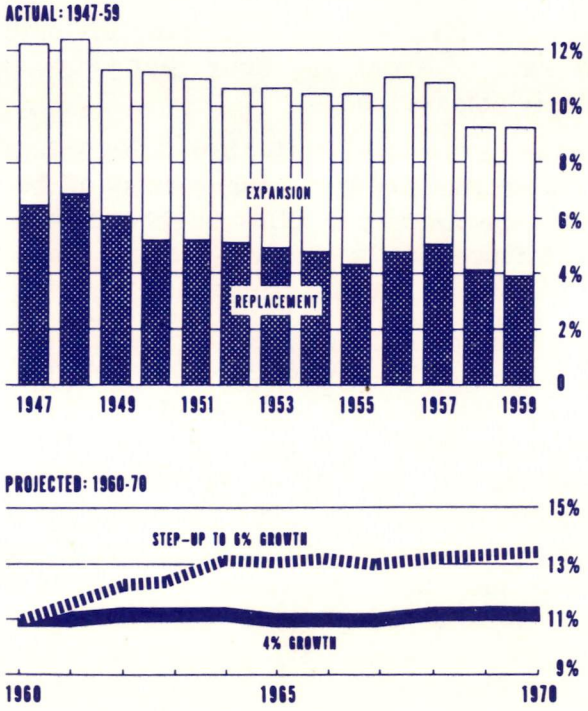
1. We must step up the proportion of our total national output going into plant and equipment investment.

This proportion is now about 11%. Advancing it to 13% would set in motion a slow but progressive lessening in the average age of our capital stock of plant and equipment. This would provide an impetus to rejuvenation as opposed to the present symptoms of hardening of the arteries.

It should serve within a reasonable period to raise man-hour productivity by as much as $\frac{1}{2}$ of 1% a year.

Let me illustrate by another chart:

ANNUAL CAPITAL OUTLAYS AS % OF G.N.P.



The bars at the top of the chart show that between 1947 and 1959, investment in new plant and equipment has averaged about 11% of Gross National Product each year. It is this part of capital investment that plays a crucial role in promoting growth, and this volume of investment has been sufficient to support a GNP growth rate of close to 4%.

You will note that a trifle more than half of this new plant and equipment investment has gone to replace worn-out and outmoded facilities, and a trifle less than half into expanded capacity.

The rate of such investment in 1960 promises to be just under the 11% average, after falling off markedly in the 1958-59 recession. But remember that our replacement investment has not been sufficient over many years to keep our overall stock of production facilities from perceptibly aging year by year. And remember that a continued investment in new plant and equipment at this rate almost certainly will not allow an overall growth of output at a higher rate than 4% a year.

The bottom part of the chart shows the pattern of gradual step-up in new plant and equipment investment to about 13% over the next 4 years with subsequent continuation at that rate that would be needed to support an average growth rate of 6% over the decade.

The best way to bring about an increased volume of investment is to provide incentives to make it attractive. These incentives can be achieved by providing more liberal and flexible depreciation allowances for tax purposes, including allowances that are realistically geared to the useful efficient life of plant and equipment, and by making other modifications in our tax structure. Some reform along these lines has already been accomplished. Much more remains to be done.

If our action is wisely conceived, it would not result in the loss of total government revenue. It would increase it through the enlargement of the income base subject to taxation.

2. We must strive for continued progress in curbing inflation and business recessions.

Through enlightened fiscal and monetary programs, we can do much to hold the cost of living in check and to reduce the high cost -- human and economic -- of unemployment and lost production. Reduction of these wasteful factors in our economy is essential to promotion of a sound and more rapid economic growth.

3. We must eliminate featherbedding of all types.

This involves far more than restrictive labor practices. It includes the progressive moderation of many forms of business subsidy -- among them tariff and quota protections -- that serve as an artificial support to continuation of operations upon a less than efficient basis instead of providing genuine incentives for the modernization that promotes efficiency.

Clearly, a more efficient use of labor and more efficient production are important steps on the road toward achieving greater economic growth.

4. We must reorient our farm program to the goal of useful and more efficient production.

A large number of low-income farmers presently account for only a small portion of agricultural output. We need a program that will really help these farmers to increase their productiveness by finding other opportunities with greater rewards to themselves and to the national economy. Here, too, we would advance the cause of economic growth.

5. We must eliminate racial discrimination.

In addition to its moral indefensibility, such discrimination prevents the nation from making full use of the skills of a significant portion of the population -- and therefore -- retards growth.

The list could readily be expanded, but I have set forth enough to indicate why I believe that our economic system, without any tampering with its basic tenets, is fully capable of yielding a 5% or even 6% growth rate in the decade of the 60's.

V—Conclusion

National responsibilities, dictated by the urgency of the times, call for a heightened sense of mission in the economic field as well as in other fields.

We should reject a detailed blueprinting of economic plans that could only be carried out by rigid government dictation.

We should embrace the responsible formulation of national aims that can serve as a guide to the part that should be played by all parties, public and private, under democratic institutions.

It is unlikely that our performance will exceed our aim.

Unless we ourselves have full confidence that our economic institutions can produce first-rate results, we cannot expect others to give them that rating.

It is in this context that I would urge you to give consideration to the human problems of automation.

Like all movements that induce rapid change, automation brings with it problems of deep human concern. But I am convinced that the solution to these problems can be found within the framework of accelerated economic growth.

And since automation, in its broadest sense, is also one of the more important instruments for promoting growth, I urge that you give this consideration the high place that it deserves in the deliberations of this conference.

For in promoting growth, we promote that which must always be uppermost in our minds -- the welfare of the men and women of America.

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ECONOMIC INTELLIGENCE

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INTEREST AND CAPITAL FORMATION

E. S. HANSCH

1959

203 N.E. 113th Ave
Portland 20, Ore.

GREAT MEN ARE DANGEROUS

Great men are dangerous - they crack the crust
Of staling times with rebel sword and tongue,
And smite with bolts of purging flame among
The shrivelled timbers of our reasoned lust.
Not death avails, nor mock or envious thrust:
Their silenced thoughts outroar the rabble's lung;
From timeless graves their voice is still outflung
To lift a choking world from out the dust.

Give us great men, O Lord, give us great men,
Not to dictate, though virtue be the goal,
Or press the sheepish throng through heaven's gate:
But men with blazing hearts, whose spirit-ken
Kindles the stellar flame in our own soul,
Men who will teach us to become as great.

AMOS FRANCESCHELLI

(in Journeyman's Almanac - 1958)

Note: The views expressed in the following pages are not those of any particular group, but are my own, and I assume full responsibility for them. - E.S.H.

Interest and Capital Formation.

Interest as a return to capital has been the subject of discussion for many centuries. The Greek philosopher Aristotle had something to say about it, and we find references to the subject even in the Bible. During the Middle Ages the Church in following Aristotle's views, forbade the charging and taking of interest. The discussion pro and con waxed very hot at times because it was thought by many to be ethically and morally wrong to take interest on loans. People then had not yet conceived of the marginal efficiency of capital, and loans were sought mostly by those who were in dire financial straits, and not for the purpose of "producing more wealth". Public sympathy was usually with the distressed persons seeking loans.

Over the last two centuries several theories have been used to explain and justify interest as a return to capital.

Capital goods as we possess them today and use them, help us produce many times what we could produce with our bare hands only. It is therefore not surprising to find a theory that makes this increased productivity the basis for the explanation and justification of interest.

However, of this theory Henry George has said that if interest depended upon and were determined by the productive power with which capital could aid labor, then the rate of interest should be steadily increasing. But obviously, interest is not many times what it once was. There seems to be a fairly constant level, an average level of the rate of interest.

Another theory brings out the thought that abstinence from current or immediate consumption should be rewarded. This theory had its proponent and defender in Senior.

Karl Marx spoke of exploitation in connection with interest.

Boehm-Bawerk suggested the agio-theory, or theory of differential values between present and future goods.

Schumpeter sought the origin of interest in the application of new combinations of factors of production with greater results, a theory of dynamics, so to speak, and this term has actually been applied to it.

More recently, Keynes elaborated a theory of interest which took as its basis the marginal efficiency of capital which Keynes explains in these words (from his General Theory, p. 135):

"When a man buys an investment or capital-asset, he purchases the right to the series of prospective returns, which he expects to obtain from selling its output, after deducting the running expenses of obtaining that output, during the life of that asset. This series of annuities it is convenient to call the prospective yield of the investment."

"Over against the prospective yield of the investment we have the supply price of the capital-asset, meaning by this, not the market-price at which an asset of the type in question can actually be purchased in the market, but the price which would just induce a manufacturer newly to produce an additional unit of such assets, i.e. what is sometimes called its replacement cost. The relation between the prospective yield of one more unit of that type of capital and the cost of producing that unit, furnishes us with the marginal efficiency of capital of that type. More precisely, I define the marginal efficiency of capital as being equal to the rate of discount which would make the present value of the series of annuities given by the returns expected from the capital-asset during its life just equal to its supply price. This gives us the marginal efficiencies of particular types of capital-assets. The greatest of these marginal efficiencies can then be regarded as the marginal efficiency of capital in general."

"If there is an increased investment in any given type of capital during any period of time, the marginal efficiency of that type of capital will diminish as the investment in it is increased, partly because the prospective yield will fall as the supply of that type of capital is increased, and partly because, as a rule, pressure on the facilities for producing that type of capital will cause its supply price to increase."

"Now it is obvious that the actual rate of current investment will be pushed to the point where there is no longer any class of capital-asset of which the marginal efficiency exceeds the current rate of interest. In other words, the rate of investment will be pushed to the point where the marginal efficiency of capital in general is equal to the market rate of interest."

Marginal efficiency of capital can therefore be considered as an influence on the demand side, while the factor of quantity of money or available savings would be a determinant on the supply side in the capital funds market.

Causing considerable oscillations between them would be the factor of liquidity preference which has a strong psychological element in it since it is influenced by general business prospects and profit expectations. From the interactions of these factors the incidence of the rate can be assumed to result. In order to bring forth an increase in savings when the demand for investment rises, a higher rate of interest would seem the answer. But the marginal efficiency of capital is here obviously the limiting factor.

But to come back to our listing of theories of interest: There is even the theory which thinks of interest as compensation for the loss of purchasing power due to inflation, an idea which is used sometimes in present-day ads by investment brokers.

It should be mentioned in this connection that in times of advancing inflation, when price increases are expected to occur more or less as a matter of course, part of the interest has to be considered as "hausse premium". Loans are contracted the nominal price or money value of which is expected to be de-valued due to price-inflation, and repayment of the loans in the stipulated

amounts is therefore made easier. The degree to which the repayment is estimated to be easier is expressed by the "hausse premium".

Henry George considered the increase given by nature through growth and reproduction as the basis of interest. This concept stems undoubtedly from the periods in history when herds of cattle and sheep, or fruit trees and the like, were considered a man's capital. I do not wish to entirely exclude this concept, but think that in a predominantly industrial economy the productivity theory, or rather its derivative, the theory using the marginal efficiency of capital, has the greater merit.

In the practical aspects it is, of course, a question of how well I can use my own capital or savings, as against the use which someone else might be able to make of it. I am disregarding for the moment the existence of savings banks and similar financial institutions set up to channel the savings to the places of investment, and in so doing offer a certain rate of interest to the savers.

The financial world is really something secondary in existence - not in importance, of course; it has become of very great economic importance today. But supporting this entire financial superstructure is our industrial and commercial activity, namely manufacture and trade.

When I mention capital it should always be understood that capital in the sense of political economy is meant, actual, tangible articles of wealth used to produce more wealth. Keynes' term is capital-assets. Money savings or capital funds are just representing these articles, or, at any rate, can cause them to be produced.

We were asking the question, how well can I use my own capital as against the use that someone else might be able to make of it. If I use it myself, the reward for not immediately consuming it is obviously the increase in productivity it gives to my labor. It must give me more than what could be represented as my wages, which wages I could earn, presumably, anyway by working for someone else and using his capital.

On the other hand, he who wants to use my capital must be able to offer an inducement to me greater than what I myself can obtain from its use. That is obvious. He, in turn, is limited in his offer to me by what the capital will help him earn, set against the earnings of his competitors, or, in other words, he is limited in his offer to me by the marginal efficiency of capital. An advantage in using someone else's capital can only be gained by using it with better results than the competitors. When the general level of productivity has caught up to him, he again has to look for better ways to use capital.

Someone will therefore use capital if he can get it cheaper than the marginal efficiency it affords him. But with that he will also have to bid for the supply of capital funds against his competitors. All this shows that the rate of interest in a highly industrialized economy is not apt to increase without limit.

Another factor that has an influence on the rate of interest is the total amount of money savings available for investment.

There is nothing in our economy that will tend to regulate the amount of savings relative to the desired investment. At any one time, demand for capital funds may be in excess of money savings, at some other time there may be more savings than demand for them. In times past, there has always been the business cycle that could be depended upon to prevent the demand for investment to rise too far beyond actually effected savings.

Since presumably the collection of groundrent for government revenue is to bring about an improvement in the distribution of income, we should then have fewer very large fortunes, which would mean, according to the testimony of many economists, a declining rate of saving.

Moreover, saving habits in a stronger and healthier economy might conceivably be quite different from what they are today, or have been in the past. With improved conditions for job and business opportunities, there may be less inclination to save and greater disposition to spend "now" and enjoy the immediate advantage of "gadgets". And with government being better able to provide for the education of our children through college, and pension plans approaching Mr. Townsend's ideal, two important incentives for the individual to save may be greatly reduced. Of course, pension funds would still accumulate savings that can be and are so used for investment by institutions. In Sylvia Porter's column in the Oregonian of October 8 is this statement:

"Corporation funds alone hold over $9 billion of stocks listed on the New York Exchange. In the past decade, pension funds have increased their ownership of stock 1720% !"

And further on we read in the same column:

"Now, mutual funds alone hold over $10 billion of stocks listed on the Big Board in New York, 620% more than a decade ago. Other investment companies hold another $4.4 billion."

Again I quote another passage from the same article:

"The stockholder in 1929 was primarily an individual. Now this is no longer true. A great and growing force in the stock market is the institutional investor - the pension fund, the mutual fund, the savings institution, the life insurance company, the personal trust fund, the foundation! No one can yet grasp the full significance of this development; we know it is of towering importance." (Unquote).

Saving habits among consumers can be influenced to some limited extent by a change in the rate of interest. But to rely on a growing rate as an inducement to increased savings could have undesirable consequences both socially and economically.

Socially, because only a part of the population could take advantage of the increased inducement. With many spending units at the lower end of the income scale it is just not a question of taking advantage of the higher rates since all those spending units can generally do is to make ends meet, if not worse.

And economically, because it is felt that there is a limit to an economic rate of interest as we have seen in discussing

the marginal efficiency of capital.

It would seem then that the aggregate amount of savings by consumers is not very elastic, except perhaps under extreme and abnormal conditions, such as we have seen during war-time, for instance. At the end of World War II, there was a pent-up effective demand for consumers' goods, and consumers divested themselves of a large part of their war-time savings. On the manufacturing side there was fortunately also a considerable reserve of funds created by large war-time profits that came handy for the needed expansion of production facilities, or reconversion of existing ones to peace-time uses. And where the need arose for additional investments the banks were glad to oblige.

Bank credits are quite elastic, or can be made so through manipulations by the Federal Reserve System. That is, credit can be granted to industry and commerce in excess of actual savings. The natural consequence of such excess credit is an inflationary tendency of the money supply, which means that consumers have to give up part of their purchasing power without being asked their consent nor offered direct compensatory benefits.

A fluctuating rate of interest is generally thought of as resulting from the supply and demand situation, the rate rising when demand exceeds supply, and vice versa, keeping in mind, of course, the limitations set by the marginal efficiency of capital beyond which the rate actually cannot rise.

However, we must take note here of several factors which interfere with the free interplay of economic forces in arriving at a rate of interest in the market place.

One is the very fact of the existence of our government debt. Apart from instances where such indebtedness is used to finance public works, this debt is just a convenient means offered to savers to obtain interest from a rather secure investment, some of which is even tax-exempt, and the interest on it must be raised by the taxpayers in general. It cannot be considered as a means of using wealth for the production of more wealth, which is after all the basic definition of capital.

Government bonds used mostly for refunding of existing debts, are bidding against industry's and commerce's demand for capital funds, and thus keep the rates artificially higher than they would otherwise be.

It can also be seen from this that if Government ever decided to retire our huge public debt, this would be a disastrous calamity for the capital funds market.

Besides, as is well known, the self-regulatory function of a fluctuating rate of interest according to demand and supply is often severely interfered with by government fiat through the agency of the Federal Reserve Board. The rates are raised or lowered according to what objective it is desired to be achieved. When inflation threatens as an accompaniment of boom-times, the rates are raised to prevent an over-expansion of credit, and when depression threatens or has set in, rates are lowered to stimulate investment. The opinions regarding the efficacy of the Federal Reserve Board's

actions are not unanimous. But since the causes and cures of inflations are not the subject of our discussion, I shall refrain from further comments on this point.

Another circumstance that beclouds the issue of the regulatory action of the law of supply and demand on the capital funds market is the fact that land - in the meaning of political economy - is thrown in with capital, both being labelled with the expedient term "factors of production", and no distinction is made between them economically. Hence, the prevailing rate of interest must necessarily contain a very strong part of what by rights and common sense - and even according to a strictly scientific definition - should be called rent. And since land is being used extensively as collateral for investment loans, it can be seen that the level of interest rates is greatly influenced by the rent.

As long as this confusion between land and capital persists, we cannot gain a true and clear picture as regards interest rates.

We said that land is being used as collateral for investment loans, and it must be added that rent is likewise used for extensive expansion in indsutry. Opponents of the proposal for site value taxation point to this fact as proof that the movement aspires to the impractical. Because by diverting rent to government use as revenue in lieu of taxes, - or let us put it: in lieu of <u>many</u> taxes - land becomes, not valueless or worthless, but <u>priceless</u>, and therefore useless as collateral.

Later on a suggestion will be indicated as how to overcome this dilemma. But first let us look at another phenomenon which has become prominent in our corporation studded economy, and which also has a bearing on interest rates and capital formation, and befuddles the picture still more.

This is the re-investment of huge profits by large industrial and commercial corporations. For the most part these profits are backed by rent-of-land. The steel industry is an example. It is perhaps unfair to single out this industry as there are many others with so-called administered prices, which is a polite cover-up for monopoly prices.

Presumably many people will object in shocked consternation to the suggestion that the re-investment of profits may not be socially or economically desirable. But let us for a moment analyze the situation.

Using the steel industry again as an example, anyone wanting to get into the business of producing iron and steel will have to get hold of iron ore deposits, or at any rate, of the ore. Since we have an ever increasing population and a constantly increasing per-capita consumption of most everything, including iron and steel products, and only a limited - not necessarily a small, but still limited - supply of iron ore which in economic jargon is called a non-reproducible asset, the price for this ore, according to the law of supply and demand, must go up, especially since the other factors of production, capital and labor, have essentially strong institutional safeguards that keep interest and wages from going down, numerically. Thus, the companies that own iron ore deposits must reckon part of their income as rent-of-land.

According to Robinson, Morton and Calderwood, in "An Introduction to Economic Reasoning", between the years 1947 and 1950, retained business earnings financed about half the new plant and equipment purchased by American industry. It does not necessarily mean that only those corporations that had rent-of-land backed profits did do it, or could do it, but the process seems most prominent in areas of industry with administered prices.

In any case, it appears that by not distributing corporation profits, the producer-consumers - a somewhat awkward term which, however, designates the dual role which these people play in the economy - are actually prevented from making the savings represented by the differential between the administered prices and the prices that might prevail due to the normal process of free competition.

The producer-consumers - and we should include the stockholders - are thus deprived not only of the opportunity to make the savings and of the right of disposal as to how and where to invest them, but they are also deprived of the interest income from such possible savings. It is true, of course, that the stockholders of the corporation with re-invested profits gain with the appreciated values of their stock. But if prices were lowered instead, then the entire community would gain.

The corporations that reinvest their profits in new plant or in expansion of the existing plant, are in an economically more advantageous position than those of their competitors who have to go to the capital funds market for their investment requirements and pay the often not inconsiderable rate of interest and subject themselves to stringent terms of the loan.

Besides, corporations that have their own resources for investment and expansion avoid being subject to the credit restrictive policies and measures of the monetary authorities. And perhaps these corporations are quite possibly the ones most in need of restriction, if restriction is considered a good feature. They are most likely to overshoot the mark when it comes to investments in boom-times, and that to the hurt of the entire community.

A Federal Reserve Bulletin of June 1956 which gives statistics on sources and uses of funds for 295 selected corporations for the years 1954 and 1955 seems to bear out the data by the aforementioned authors. Plant and equipment expenditures for these corporations in 1955 are stated as over $11 billion, and the amount "Net from Operation" as slightly higher. Bank loans, both short and long term, are not over $230 million. This indicates that a very large part of profits goes into re-investment.

The authors mentioned say of these re-invested profits: "When this happens, the corporation functions as a device to induce the group to save more than they would as individuals." It would come closer to the facts to call this a form of forced savings.

Since the tax structure of most civilized and industrialized nations cuts heavily into the incomes of individuals and businesses, the propensity to capital formation has often been given special attention by the tax imposing bodies, and special privileges have been granted, ostensibly with the aim to facilitate capital

accumulation. The far-reaching social-economic consequences of such favored treatment are somewhat outside the compass of this essay and shall therefore not be discussed here in detail.

Capital formation in many countries is very slow and cumbersome, so for instance in India. We in America have a good head start, and capital goods, or capital assets if you wish, really help us produce enormous masses of both consumer goods and also more capital.

When Communist Russia first started up in 1917 there was practically no capital available in that country, and outsiders did not like to invest theirs. The Russian government offered interest to individual savers, but had to resort substantially to forced savings. They used the method of monetary inflation, by just speeding up the printing press. Of course, these forced savings were used as capital funds to expand their industrial production in the main. In later years the so-called turn-over tax came into prominence.

Other cases of government printing press inflation in the past have not always had such beneficial results, they were mostly used to create unproductive debts, or to pay off those debts that had already been incurred as through a war, or perhaps to cover the heavy expenditure of some potentate or corrupt government.

While on the subject of interest mention should be made of an idea that by many may be considered strange or curious, and is thought by some to be outright idiotic. And that is the matter of negative interest.

Keynes arrives at that concept from considerations derived from an analysis of the rate of interest not of money, but of commodities. He says, just as there is a rate of interest on money, so is there a rate of interest on wheat, houses, steel plant, etc., figured not in terms of money but in terms of wheat, houses, steel plant, etc. He cites an example using the forward quotations for wheat, but the example is unfortunate since forward quotations of commodities are not a function solely of time, but have quite other, namely speculative elements determining them preponderantly. He is duly attacked and literally shredded to pieces by his fellow economists for this example gone sour. However, there is also an element of truth in it.

And that is shown by the following taken in substance from Silvio Gesell:

All goods and commodities produced are subject to decay, deterioration, erosion, etc. Gesell enumerates a whole series of such influences as heat, frost, rust, oxydation, insects, rotting, obsolescence, friction, normal wear and tear by use, etc. etc.

And the following is taken from Henry George's book "Progress and Poverty" - p. 148:

"It will be well for a moment to consider this idea of accumulated wealth. The truth is that wealth can be accumulated but to a slight degree, and that communities really live, as the vast majority of individuals live, from hand to mouth. Wealth will not bear much accumulation; except in a few unimportant forms it will

not keep. The matter of the universe, which, when worked up by labor into desirable forms, constitutes wealth, is constantly tending back to its original state. Some forms of wealth will last for a few hours some for a few days, some for a few months, some for a few years; and there are very few forms of wealth that can be passed from one generation to another."

Silvio Gesell suggested, as will be recalled, stamped money-bills to increase the cost of hoarding money. He felt that the economy came to a faltering pace by savings withheld from spending or investment. The method of stamped money-bills would have driven out of hiding the money that some suspicious European peasants might have buried in tincans under the walnut tree in their backyards, and the effect on the economy - even on those of the small size in European countries - would have been almost negligible.

However, Keynes proposed to extend the idea of increasing the carrying cost of money to all kinds by what he called "analogous methods". His analytical arguments in favor of such a measure should, however, be supplemented with the consideration that fortunes made in one generation have no inner functional and moral connection with the production of succeeding generations. They should, therefore, not be allowed to make claims on that production. A similar reasoning can be applied to debts.

If a rate of 1% p.a. were used on our public debt, we could look forward to have the entire debt wiped out equitably and without serious disturbance to our economy within about 100 years.

But let us go over the points I made in some sort of review, and then bring this essay to some tentative conclusion.

First I mentioned the changed attitude toward the charging and taking of interest on loans since ancient times and through the Middle Ages, then the various theories that were advanced and which purport to explain and justify interest as a return to capital.

I mentioned Keynes' concept of marginal efficiency of capital, also how in practice the self-levelling of the rate of interest according to economic forces is severely tampered with by various of our institutions, one being the actions taken by the Federal Reserve System, another the existence of our huge public debt, still another the fact that rent is included in the rate of interest. Then we considered capital formation under various conditions, and it was brought out that there was an anomaly in the procedure of reinvestment of profits by industry. We also mentioned the lack of balance between savings and investment requirements in the national economy.

There is one more point that should be touched upon before leading up to the conclusion, and that is what Keynes has called his desire to see the euthanasia of the finance capitalist (rentier).

For this stand, incidentally, he has been taken to task by Prof. Harry G. Brown who accused Keynes of having singled out the finance capitalist to be held up for contempt for enjoying the interest income on his capital, but not explicitly saying anything against the landowner for collecting rent as private income. Now the reason for this is obviously not Keynes' one-sided aversion toward finance

capitalists as against landowners, but merely the fact that Keynes had not yet freed himself, the same as so many other economists, from the mistaken idea of calling both land and capital by the inclusive term "factors of production". So then, landowners are not set apart, and rent is considered just a special form of interest on the investment in land.

Such a mistaken concept could not easily survive if economists would give attention to what Henry George had to say about the two kinds of value, namely (1) value brought about through exertion (= labor), and (2) value from obligation, to which latter class the private property in land belongs.

Incidentally, Keynes firmly expected the economy to become saturated with capital assets eventually, in which case the rate of interest would approach zero. Since land values simply are the capitalized amounts of groundrent, it would follow that these land-values would assume astronomical proportions.

Keynes, as already mentioned, wanted to see what he chose to call the euthanasia of the finance capitalist.

There is a book titled "The Future of Industrial Man" by Peter Drucker, in which the author vividly describes how far removed the present-day finance capitalist is from our production processes and problems. He is only interested in his returns, and buys and sells stocks and bonds without consideration for the continued existence and health of any worthwhile industrial corporation. If the stock market turns panicky, and the banker friends of the corporation managers cannot help out, the corporation simply goes bust.

Although stockholders have the right, and are even invited to attend stockholders' meetings, very few of them want to bother, and the business of managing a corporation is generally left to the judgment of its directors. There is no close connection and interest other than income and profit motives. Absentee ownership is not even the right word to describe it, because management is left in many cases absolutely free and unchallenged to decide policies and other important matters.

This lack of interest on the part of the stockholders may have its good side especially in prosperous times, but in a pinch there is no stockholder interested enough in the welfare of the corporation to stick to the guns and see it through; it is every man for himself.

Many corporations make a great showing of "service to the customers, or to the public" as a sort of justification of their use of the absolute power with which managements find themselves left, and they are not altogether happy about the situation.

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Our short and necessarily sketchy survey of the matter of capital formation has shown us, it is believed, that the situation is really somewhat precarious. It seems of the greatest importance for the continued health and growth of our economy - especially since we are in such a deadly competitive struggle with another ideology -

that we should have available at all times, or can make available for almost immediate use, the capital resources of this nation needed for a rapid expansion of our industry, and in all directions.

We are constantly confronted with the necessity of making decisions between the rapid adoption of the latest, most up-to-date capital-assets, and the effect this may have on the owners of the already existing ones.

As a practical example we cite the developments in transportation from the stage-coach to the railroads to trucks and to airplanes and jet-planes. At every stage along the way, we had to discard a constantly increasing amount of capital-assets that had become obsolete through technological advances, and perhaps in some cases through a change of tastes or fashions.

This choice becomes increasingly more difficult with the greater amount of capital-assets in use, and their comparative costliness, and one result is the loud cry for government subsidies by owners of obsolete but still usable, i.e. not yet worn-out capital-assets. Today, the burden of the cost of the change-over is mostly on the individual owners of the obsolete assets.

Yet another consideration should make us sit up and take notice. It may be thought to be economically advisable, or strongly desirable, if not even politically or for defense reasons unavoidable - just as an example - to change our existing power generating system over to one of the nuclear types. This would necessitate a rather large outlay of capital, and possibly within a very short time.

Perhaps the government would step in again with a replica of the Defense Plant Corporation plan known from World War II But that would bring us back to government financing of private industry.

On the side of private investment, our industrial corporations are exposed to the whims and sometimes to the unreasoning fears - or boundless optimism - of the stock market. We also have government interference at short notice, or no notice at all, in the sudden changes of interest rates, bank reserve requirements, and other Federal Reserve System or U.S. Treasury manipulations of the money market, with the ensuing instability of the entire financial structure.

The individual stockholder is cut out more and more, partly because of the self-financing operations of large corporations partly by the investment of large financial institutions, such as were mentioned before: the pension funds, life insurance companies, etc.

The rate of interest as a return to capital, which is supposed to result from an interaction between the supply of money in the form of savings and the marginal efficiency of capital in the production process, cannot show its true level. This level is falsified by the existence of our huge public debt, by the inclusion of rent-of-land, and also by government interference to fight inflations or help business recovery, as already stated. And the measures taken by the monetary authorities for the purpose of fighting inflation are not effective as far as the large self-financing corporations are concerned. It is therefore not surprising to find economists and lawmakers increasingly insisting on the nationaliza-

tion of our banking operations and capital formation. But all too well known are the compulsion, coercion, red tape, etc. connected with such an institution. A bureaucratic government agency can never replace the flexible, efficient private banking system. What then would be a better solution of this dilemma?

To what I am going to propose there will, quite naturally, be strong objections; that is human nature. The eight hour day, abolition of child labor, even the abolition of slavery were one and all preceded by the strongest protestations of impracticability.

I am taking my stand, however, on the maxim stated by the Austrian scientist and philosopher, Dr. Rudolf Steiner:

"The human life can only be lived in its fullness when moral imaginations are given their place in our lives."

The idea of collecting the rent-of-land in lieu of taxes for government revenue springs from this fountain of moral imaginations. The movement which espouses this idea, wants to remove rent from the private domain to the common - not government - domain; and then, as a distinct second step, this rent would be turned over to the government for the defraying of its expenses, mainly to pay for the services which the government performs and which services throughout benefit the land - all land in varying degrees. Through this second step it follows that in as much as each citizen has the right to an equal share in the total rent, each contributes his equal share to the government. This arrangement would plainly meet the requirement that each citizen should contribute something to his government which is voiced so frequently in discussions concerning matters of tax equity and tax base.

With these considerations in mind, it seems logical to likewise have resort to the common domain to obtain the needed funds for capital investment.

It would then be necessary for our elected representatives in Congress to stipulate the total amount so to be used and allowed. This total amount would be arrived at conceivably with the advice of economic organs - not governmental ones ! - that is, organizations whose members come only from industry and commerce. In this way, an upper limit for the total annual amount of investment to be used for the expansion and growth of our American industry could easily be ascertained. It will perhaps be a compromise between what industry representatives will think necessary, and Congress decides can safely and comfortably be allowed to be so used out of our gross national product.

It would then also be necessary to see that all business profits beyond the replacement and/or up-keep of existing production facilities, and of course, after taxes, be distributed in wages, salaries, and dividends, or better yet, by lower prices.

The economic organs mentioned should then decide among themselves the allocation of the total allowed amount for new investment, and this without any interference by government organs or officials.

The individual industrial or commercial concerns could

continue to arrange for the loans in the allotted amounts with their banks as heretofore, and negotiate the form of collateral, bank service charge, amortization, etc.

The rate of interest of these loans, for which the name Social Credit loans seems most applicable, but here with an entirely different connotation of the term from that used by Major Douglas - should preferably be set by the monetary authorities, and should, after deduction of the premium for risk, revert to the common domain and thence to government as an offset to taxes to compensate the producer-consumers for the sacrifice in purchasing power by making this credit available to industry and commerce.

Practical considerations would probably require to set a minimum amount of assets for the individual corporations below which the financing would not come under this operation, say perhaps $250,000 as a suggested figure. This would leave considerable scope for private investors to venture into small new enterprises. And since we conceived as rent being collected by government in lieu of taxes, small businesses would have an excellent chance for success for these reasons:

(1) It would be unnecessary to tie up large funds for land - and resources in and on land - since only the annual rent value would have to be paid. This annual rental value would be less than the interest on the speculatively inflated purchase price. Also no additional amount would have to be set aside for the amortization of the principal.

(2) Business taxes would largely be eliminated through the collection of rent by the government.

(3) Opportunities would be equalized for large and small businesses since all will have to carry the same charges on the resources and land, and no one concern would have an economic advantage by dint of cornering the limited supply (limited by nature !). This latter point should appeal especially to our sense of fair play.

With this proposed measure of Social Credit we would at once do away with our concern for liquidity preferences, propensities to consume, and meet with Keynes' desire for the almost complete euthanasia of the finance capitalist.

It may be objected that what has been outlined here is the concern of the social reformer, not that of an economist, or student of economics. However, the reformer can only see static systems or modes, and he desires to replace one with another, a better one to him, of course. While the true economist should try to fathom with "moral imagination" the changing sequences in the development of the social-economic organism. The state of this organism should reflect at any time not only the satisfaction of the immediate material needs, but in a wider sense also the higher aspirations of its members.

Another objection to the proposal could be made by citing our well advertised aversion to any planned economy. To this the answer should be:

In a mature economy it should be possible to overcome

the immature and puerile attitude which asserts: "I want to do it my way regardless of what you think of it or of how it affects you!" Besides, let us look at some features of our economy which bespeak a conglomeration of schemes and plans:

We try haphazardly to inject some sort of planning into our economy by such varied means as the import tariff; import quotas (oil!); export restrictions; stock-piling of scarce materials, or of farm surpluses; government subsidies, sometimes hidden as in reduced mailing rates; farm plans; housing projects; social security payments; unemployment benefits; pension plans; government financing of certain key industries (synthetic rubber; TVA- and similar projects; atomic and nuclear reactors, etc.); urban renewal schemes; taxation with all its ramifications of attempts to restrict the consumption of certain articles (tobacco, alcohol), or redistribution of income because of faulty distribution in the first place; rehabilitation of workers in defunct industries; money and credit manipulations by the Federal Reserve System and the U.S. Treasury; the National Budget, etc. etc.

The matter of capital formation and investment should sensibly be handled by letting those decide who should and do know where to place these investments, that is, by the men whose business it is to keep our industry running, and at a profit.

The proposed controls, if one can speak of them as controls, are of an over-all nature, and will not interfere with individual decisions over how to use the funds. They will limit the extent of the investment in new plant to prevent overshooting the mark as is so often done to the detriment of the entire community.

The allocation of funds can be compared to a family's budget where every member full well knows that the limit is considerably this side of the blue sky, but where complete freedom exists to choose either maccaroni or lima beans, pork or veal, cabbage or lettuce, and the item for recreation and amusements does not have to be spent only for movies.

The suggested price for the stabilization of our economy surely does not appear high. It should be noted that the term "stabilization"as used here is not to mean "fixation". Rather it is to signify the re-establishment of free play of economic balancing forces, and the avoidance of a top-heavy situation such as is brought about especially through monopoly in land and natural resources. -

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Note: An applicable definition of the economic organs mentioned in this text would be the one given by Dr. Benediktus Hardorp in his "Elements for a Re-determination of the Function of Money":
'The term "association" is to be taken to mean any and all social organs whose purpose it is to bring about a social consciousness so that the individual members are enabled to gain insight into basic social-economic situations and problems and their possible solutions, and have the possibility to come to freely conceived decisions regarding these situations and their contractural ordering.'