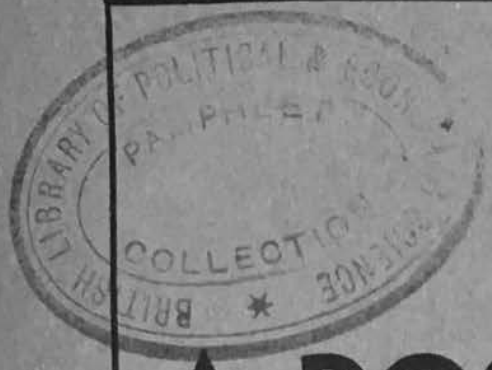
PUBLIC POLICY PAMPHLET NO. 15
HARRY D. GIDEONSE, EDITOR






# A POSITIVE PROGRAM FOR LAISSEZ FAIRE

## SOME PROPOSALS FOR A LIBERAL ECONOMIC POLICY

BY
HENRY C. SIMONS

THE UNIVERSITY OF CHICAGO PRESS

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# INTRODUCTION BY THE EDITOR

Laissez faire never was a mere do-nothing policy. Historically, it developed as a vigorous attack upon entrenched social, commercial, and industrial privilege. Economic freedom (*any* freedom?) can never be absolute freedom. It must always mean freedom within a given social framework of legal standards and regulatory practices. There is no security—as John Stuart Mill's leading pupil said in his inaugural lecture in 1870—"that the economic phenomena of society, as at present constituted, will always arrange themselves spontaneously in the way which is most for the common good."

The imperative need for a positive program of economic legislation is admitted by all parties to the present controversy over public policy. The vital issues lie between those who would inflict upon the state responsibility for all sorts of detailed regulations of economic life, and those who would preserve a competitive situation and minimize the responsibility of the state. The former is the road we are now traveling. The latter would involve a recasting of the framework within which freedom is to operate.

Professor Simons' pamphlet is an original and comprehensive plea for the preservation of economic freedom as the ultimate agency of control. His main purpose is the criticism of current policy by the definition of a vitally different program in which—in his own words—the state would undertake to establish such conditions that it might avoid the necessity of regulating "the heart of the contract," that is to say, the price system itself. This essay also gives the first detailed statement of the only novel proposal concerning banking reform that has come out of our recent disastrous experience. This so-called "Chicago" or "100 Per Cent Reserve" plan is likely to figure prominently in future discussions of monetary reform.

This is the fifteenth of a series of Public Policy Pamphlets which the University of Chicago Press is publishing. Frequently the scholarly journals give no attention at all to prob-

lems that have an acute public interest, while the ordinary magazines can print little but superficial comment. The University might well perform a valuable service by making available to the public whatever special training and information it may have at its disposal. The continuation of such a series will, of course, depend upon its reception by the public.

Perhaps it goes without saying that the authors of these pamphlets are individually responsible for their views and that they in no way involve the responsibility of the University of Chicago.

HARRY D. GIDEONSE

November 10, 1934

# A POSITIVE PROGRAM FOR LAISSEZ FAIRE

## SOME PROPOSALS FOR A LIBERAL ECONOMIC POLICY

This is frankly a propagandist tract—a defense of the thesis that traditional liberalism offers, at once, the best escape from the moral confusion of current political and economic thought, and the best basis or rationale for a program of economic reconstruction. This view has been widely ridiculed of late, by communists and fascists, by most of our "liberal" reformers and politically ambitious intellectuals. Old-fashioned liberals, and the more orthodox economists especially, have responded meagerly to the attack; only their position is inadequately represented in the welter of current controversy. Consequently, one is impelled to try, humbly but uncompromisingly, to state that position, and to indicate specifically how economic reconstruction might be achieved along lines dictated by a faith in liberty.

There is in America no important disagreement as to the proper objectives of economic policy—larger real income, greater regularity of production and employment, reduction of inequality, preservation of democratic institutions. The real issues have to do merely with means, not with ends (or intentions); but the future of our civilization hangs in balance as these issues are decided; and those whom the recent crisis has brought to positions of political and intellectual leadership seem to lack insight as to the nature of our economic ills or the effects of their own prescriptions.

We have witnessed abroad the culmination of movements from constitutional government to dictatorships, from freedom back to authority. This spectacle, for most of us, is revolting; and the experience, something to be avoided at all costs. Yet, faced with the same problems, we adopt measures and accept political slogans which call explicitly for an "American compromise," that is to say, for more authority and less freedom here and now. Thus do we justify and rationalize a

policy of accelerating movement in a direction which we overwhelmingly disapprove.

The real enemies of liberty in this country are the naïve advocates of managed economy or national planning; but with them we must agree on one vital point, namely, that there is now imperative need for a sound, positive program of economic legislation. Our economic organization is perilously near to disintegration and collapse. In earlier periods, it could be expected to become increasingly strong if only protected from undue political interference. Now, however, it has reached a condition where it can be saved only through adoption of the wisest measures by the state. Modern democracy arose under conditions which made only negligible demands for intelligence in economic legislation; it remains soon to be seen whether democracy can survive when those demands are very great.

It is the main purpose of this tract to criticize current policies, simply by defining the main elements of a vitally different program. Part I undertakes to present the minimum of general analysis or diagnosis which seems essential for exposition of the program and specific proposals presented in Part II.

# PART I

Much significance has been, and should be, attached to the simultaneous development of capitalism and democracy. Indeed, it seems clear that *none of the precious "freedoms" which our generation has inherited can be extended, or even maintained, apart from an essential freedom of enterprise—apart from a genuine "division of labor" between competitive and political controls.* The existence (and preservation) of a competitive situation in private industry makes possible a minimizing of the responsibilities of the sovereign state. It frees the state from the obligation of adjudicating endless, bitter disputes among persons as participants in different industries, and among owners of different kinds of productive services. In a word, it makes possible a political policy of laissez faire.

This policy and the correlative political philosophy, nineteenth-century liberalism, have been subjected latterly to gross misrepresentation and to shallow satirical jibes in the "new economics." The representation of laissez faire as a merely do-nothing policy is unfortunate and misleading. It is an obvious responsibility of the state under this policy to maintain the kind of legal and institutional framework within which competition can function effectively as an agency of control. The policy, therefore, should be defined positively, as one under which the state seeks to establish and maintain such conditions that it may avoid the necessity of regulating "the heart of the contract"—that is to say, the necessity of regulating relative prices. Thus, the state is charged, under this "division of labor," with heavy responsibilities and large "control" functions: the maintenance of competitive conditions in industry; the control of the currency (of the quantity and value of the effective money); the definition of the institution of property (especially with reference to fiscal practices)—not to mention the many social-welfare activities.

The great errors of economic policy in the past century may be defined—and many of our present difficulties explained—in terms of excessive political interference with relative prices,

and in terms of disastrous neglect of the positive responsibilities of government under a free-enterprise system. Our governments have tinkered interminably with relative prices (witness the tariff). On the other hand, they have never really tried to maintain effectively competitive conditions in industry (witness the "rule of reason" and the absurd grants of powers to corporations). They have evaded—when they have not abused—their responsibility of controling the currency (witness the growth of private banks which provide, and potentially can destroy, all but a small percentage of our total effective circulating media). Moreover, they have scarcely recognized the obligation, or the opportunities, of mitigating inequality through appropriate fiscal practices—that is to say, through appropriate definition of the institution of property. Consequently, the so-called failure of capitalism (of the free-enterprise system, of competition) may reasonably be interpreted as primarily a failure of the political state in the discharge of its minimum responsibilities under capitalism. This view may suggest reasons for skepticism with reference to currently popular schemes for curing our ills.

It seems clear, at all events, that there is an intimate connection between freedom of enterprise and freedom of discussion, and that political liberty can survive only within an effectively competitive economic system. Thus, *the great enemy of democracy is monopoly, in all its forms:* gigantic corporations, trade associations and other agencies for price control, trade unions—or, in general, organization and concentration of power within functional classes. Effectively organized functional groups possess tremendous power for exploiting the community at large and even for sabotaging the system. The existence of competition within such groups, on the other hand, serves to protect the community as a whole and to give an essential flexibility to the economy. The disappearance of competition would almost assure the wrecking of the system in the economic struggle of organized minorities; on the political side, it would present a hopeless dilemma. If the organized economic groups were left to exercise their monopoly powers without political restraint, the result would be a usurpation of sovereignty by these groups—and, perhaps, a domi-

nation of the state by them. On the other hand, if the state undertakes to tolerate (instead of destroying) such organizations and to regulate their regulations, it will have assumed tasks and responsibilities incompatible with its enduring in a democratic form.

Thus, for one who prizes political liberty, there can be no sanguine view as to where the proliferation of organization leads. If the state undertakes, under popular government (or perhaps under any other form), to substitute its control for competition in the determination of relative prices and relative wages, the situation must soon become chaotic. Congressional meddling with relative prices through tariff legislation has never hurt us severely, for we have had within our tariff walls an enormous free-trade area. The legislative history of the American tariff, however, does suggest most clearly the probable outcome of an experiment in the political manipulation of the whole structure of internal prices. That our political system could endure either the economic effects of such control, or its consequences for political morality, is at least highly improbable.

If popular government did for a time achieve that infinitely wise and effective control which would be necessary merely to prevent economic collapse, the system could not survive. Political determination of relative prices, of relative returns from investment in different industries, and of relative wages in different occupations, implies settlement by peaceful negotiation of conflicts too bitter and too irreconcilable for deliberate adjudication and compromise. The petty warfare of competition within groups can be kept on such a level that it protects and actually promotes the general welfare. The warfare among organized economic groups, on the other hand, is unlikely to be more controllable or less destructive than warfare among nations. Indeed, democratic governments would have hardly so good a chance of arbitrating these conflicts tolerably as have the League of Nations and the World Court in their field.

Suppression of the competitive struggle within economic groups, and their organization into collective fighting units, will create conditions such that only ruthless dictatorship can

maintain the degree of order necessary to survival of the population in an economy of intricate division of labor. Under these circumstances, the distribution of power among nations is likely, by the way, to be altered drastically in favor of those people best disciplined to submission and least contaminated with dangerous notions about the rights of man. In the Western world, the price of short-run security under such political arrangements is likely to be greater insecurity in the long run; for Western peoples will probably insist on changing dictators occasionally, even at the expense of catastrophic upheavals, disintegration of national units, and progressive political and economic separatism.

It seems nowise fantastic, indeed, to suggest that present developments point toward a historic era which will bear close resemblance at many points to the early Middle Ages. With the disappearance of the vestiges of free trade among nations will come intensification of imperialism and increasingly bitter and irreconcilable conflicts of interest internationally. With the disappearance of free trade within national areas will come endless, destructive conflict among organized economic groups—which should suffice, without assistance from international wars, for the destruction of Western civilization and its institutional heritage.

Thus, the increasing organization of interest groups (monopoly) and the resurgence of mercantilism ("planning")[1] promise an end of elaborate economic organization (of extensive division of labor, nationally and internationally), and an end of political freedom as well. If the situation is not yet hopeless because of the technical difficulties of turning back (and I refuse to believe it is), one finds abundant reason for despair in the fact that our sophisticated generation seems simply not to care. It has become unfashionable to reveal affection for democracy; and the meager curiosity about the future of our institutions leads only to the publication of our cheapest romantic literature in the guise of economics.

Competition and laissez faire have not brought us to heaven. The severe depression, regarded as resulting from competition *instead of from the lack of it*, naturally produces an impairment of our affection for the system. But the wide-

spread disposition to deprecate our institutional heritage seems explicable only in terms of general unwillingness and inability to consider seriously what the actual alternatives are—where new roads lead—or, whatever their destination, how much human suffering must be endured on the way. Few people are now interested in assessing the opportunities for remodelling the old system without destroying its foundations. Worst of all, perhaps, is the popular disposition to accept from zealous "uplifters" devices for salvaging our institutions which are, in fact, the most effective means for undermining them irreparably.

Let us consider now what circumstances are most inimical, within the old system, to production of a large social income (to economic efficiency). The effective functioning of our economic organization requires full utilization of existing resources—including labor, use of the best available technical methods, and, less obviously, economical allocation of resources among available, alternative uses. This latter aspect of the problem may well be emphasized here.

Any judgment of efficiency implies a standard or scale of values—merely physical efficiency is an absurd conception. For economic analysis, such a scale of values is available in the market values (prices) of commodities. These market values, being the result of competitive purchase by persons free to utilize purchasing power as they please, may be accepted as measuring roughly the relative importance (for the community) of physical units of different things. To be sure, these prices are the result of free disposition of purchasing power by individuals of widely different income-circumstances. But the problems of efficiency and of inequality may usefully be separated for purposes of discussion—and properly, if one accepts the view that the appropriate measures for improving efficiency and for mitigating inequality are, within fairly wide limits, distinct and independent.

Efficient utilization of resources implies an allocation such that units of every kind of productive service make equally important (valuable) contributions to the social product in all the different uses among which they are transferable. Such

allocation will be approximated if, by virtue of highly competitive conditions, resources move freely from less productive (remunerative) to more productive employments. It is an essential object of monopoly, on the other hand, to maintain an area of abnormally high yield (productivity), and to prevent such influx of resources as would bring the monopolized industry down to the common level. Any effectively organized group may be relied upon to use to this end the power which organization brings.

Monopoly thus means the exclusion of available resources from uses which, on the market-value standard, are more important, and, therefore, means diversion of resources to less important uses. Every organized group, whether of employers or of workers, possesses great power, both for exploiting consumers and for injuring other groups of producers to whose industries resources are diverted by virtue of the monopoly restrictions.

Such characterization fits best the case of the strongest and most nearly complete monopolies. For the more typical, partial monopolies (the organization basis for which the National Recovery Act has sought to establish everywhere), the situation is somewhat different, and possibly worse from the viewpoint of the community at large. The looser forms of organization for price maintenance and output control (cartels, trade associations), while able to enforce output limitation upon existing firms, are seldom able to restrict the growth of investment (to control the number and size of firms); nor does their position permit them to withhold output quotas from newcomers in the industry. Such arrangements lead to gross wastage of investment as well as to exploitation of consumers. New firms, attracted by the high returns resulting from price maintenance, will construct plants; and they will be drawn into the organization and given their appropriate quotas (presumably on the basis of "capacity"). This means reduction in the quotas of other firms, and increasingly meager utilization of plant capacity throughout the industry. Finally, producers within the organization may obtain, in spite of the price maintenance, no higher return on investment than prevails in competitive fields. But consumers will be paying heavily, in high-

er prices, for the policies of the organization; and the industry will end up with much smaller production, in spite of much larger total investment, than would have obtained under competitive conditions. In technical language, equilibrium under the cartel or trade association form of monopoly means equality between average cost and price, in spite of enormous discrepancy between marginal cost and price. This, in general terms, describes the goal toward which "planners" unwittingly direct us.

The situation is strikingly similar with respect to trade-union monopoly, which usually involves a similarly partial monopoly power. The main device of trade-union strategy is the maintenance of the standard rate of pay, through collective bargaining. The raising of rates of wages in a particular field above the competitive level, by whatever methods of coercion, serves to diminish the volume of employment available within that field—inducing economy of such labor by substitution (of machinery and of other labor) and relative contraction of the industries requiring such labor. If the organization admits newcomers freely and rations employment, the occupation may continue to grow in numbers, or fail to decline, in spite of decline in the total amount of employment available—the increased rate of pay more than offsetting, for a time, the reduction in employment available per man. As with the trade association, numbers may increase until the members are no better off than they would have been without any organization at all. Yet product prices in the industries concerned will be higher; and a large part of the community's labor resources will be wasted—a situation which roughly describes, except for the denoument, recent conditions in coal mining in the Midwest. If the union can prevent entrance into the trade, if the older members are given full employment before newcomers are employed at all, or if the demand for this kind of labor is highly elastic, the effects of the wage control in this particular field will manifest themselves largely in diversion of labor into less important *and less remunerative* occupations. In any case, the diseconomies for the community are sufficiently evident.

The gains from monopoly organization in general are likely,

of course, to accrue predominantly to the strong and to be derived at the expense of the weak. Among producers, organization is least expensive and most easily achieved, as well as most effective, within groups whose members were unusually large and prosperous at the outset. Among workers, the bias is not less striking. The most highly skilled and most highly remunerated trades are the trades where organization is least difficult and where the fighting strength of groups once organized is greatest. Little evidence, inductive or analytic, can be conjured up to support the popular conception of trade unionism as a device for raising incomes at the bottom of the scale. Its possibilities lie mainly in the improvement of the position of labor's aristocracy[2]—and largely at the expense of labor generally. Here as elsewhere the gains from monopoly are exploitative. The restriction of employment in the more remunerative occupations injures other laborers, both as consumers and as sellers of services rendered more abundant in other areas by the restriction.

Another major factor in the inefficient allocation of resources is to be found in government regulation and interference. Tariff legislation is again the main case in point; for the protective tariff is essentially a device for forcing resources from uses of higher to uses of lower productivity. Moreover, there are good reasons for believing that political controls will generally work out in this way. Government interference with relative prices is in the nature of arbitration of conflicts of interest between minority producer groups and consumers (the whole community); and such interference inevitably involves decisions which have regard primarily for the interests of the minorities. Producers are, from a political point of view, organized, articulate groups; and it is in the nature of the political process to conciliate such groups. Anyone may detect the notorious economic fallacies, and thus see the dictates of sound policy, if he will look at every issue from the viewpoint of consumers; but no politician can be expected to do this, or to act on his conclusions if he does, except in a world where legislators are motivated primarily by the desire to be retired at the next election. People as consumers are

unorganized and inarticulate, and, representing merely the interests of the community as a whole, they always will be. This fact, perhaps, suggests the decisive argument for laissez faire and against "planning" of the now popular sort.

While the tariff is the example par excellence of how the political process works in the control of relative prices, our experience with regulation of the so-called "natural monopolies" is also instructive. With the railroads, the abuse of private monopoly power led finally to real control over the prices of services. We have developed in the Interstate Commerce Commission an unusually competent and scrupulous public body. Even here, however, the preposterous system of relative charges (freight classification), and the disastrous rigidity of freight rates during the depression, testify eloquently to the shortcomings of the regulation expedient; the intrenched position of the Railway Brotherhoods indicates clearly how governments reconcile the interests of small, organized groups and those of the community at large. In the field of local utilities, a half-century of effort at regulation yields up a heritage of results, a cursory inspection of which should suffice to dampen anyone's enthusiasm for a system of private monopoly with superimposed government regulation.

Public regulation of private monopoly would seem to be, at best, an anomalous arrangement, tolerable only as a temporary expedient. Half-hearted, sporadic, principle-less regulation is a misfortune for all concerned; and systematic regulation, on the basis of any definite and adequate principle, would leave private ownership almost without a significant function or responsibility to discharge. Analysis of the problem, and examination of experience to date, would seem to indicate the wisdom of abandoning the existing scheme of things with respect to the railroads and utilities, rather than of extending the system to include other industries as well. Political control of utility charges is imperative, to be sure, for competition simply cannot function effectively as an agency of control. We may endure regulation for a time, on the dubious assumption that governments are more nearly competent to regulate than to operate. *In general, however, the state should face the necessity of actually taking over, owning, and managing*

*directly, both the railroads and utilities, and all other industries in which it is impossible to maintain effectively competitive conditions.* For industries other than the utilities, there still remains a real alternative to socialization, namely, the establishment and preservation of competition as the regulative agency.

Turning now to questions of justice, of equitable distribution, we may suggest that equitable distribution is at least as important with respect to power as with reference to economic goods or income; also, that the cause of justice, perhaps in both directions, would be better served if well-intentioned reformers would reflect seriously on what their schemes imply with respect to the distribution of power. Surely there is something unlovely, to modern as against medieval minds, about marked inequality of either kind. A substantial measure of inequality may be unavoidable or essential for motivation; but it should be recognized as evil and tolerated only so far as the dictates of expediency are clear.

If we dislike extreme inequality of power, it is appropriate to view with especial misgivings the extension of political (and monopoly) control over relative prices and incomes. Either socialization or the mongrel system of "national planning" implies and requires extreme concentration of political power, under essentially undemocratic institutions. A system of democratic socialism is admittedly an attractive ideal; but, for the significant future, such a system is merely a romantic dream. On the other hand, it seems unlikely that any planners or controllers, with the peculiar talents requisite for obtaining dictatorial power, would be able to make decisions wise enough to keep an elaborate economic organization from falling apart. Even if one regards that prospect as not unpromising, the implied division of power between controllers and controllees would seem an intolerable price for increased efficiency.

An important factor in existing inequality, both of income and of power, is the gigantic corporation. We may recognize, in the almost unlimited grants of powers to corporate bodies, one of the greatest sins of governments against the free-enter-

prise system. There is simply no excuse, except with respect to a narrow and specialized class of enterprises, for allowing corporations to hold stock in other corporations—and no reasonable excuse (the utilities apart) for hundred-million-dollar corporations, no matter what form their property may take. Even if the much-advertised economies of gigantic financial combinations were real, sound policy would wisely sacrifice these economies to preservation of more economic freedom and equality.

Another cardinal sin of government against the free-enterprise system is manifest in the kind of institution of property which the state has inflicted upon that system. It has lain within the powers of the political state, in defining rights of property and inheritance, to prevent the extreme inequality which now obtains; and the appropriate changes might still be effected without seriously impairing the efficiency of the system. In a practical sense, there is not much now wrong with the institution of property except our arrangements with respect to taxation. Instead of collecting their required revenues in such manner as to diminish the concentration of wealth and income, governments have relied on the whole upon systems of levies which actually aggravated inequality. Until recently (and the situation is not strikingly different now) governments have financed their activities largely by conglomerations of miscellaneous exactions which have drawn funds predominantly from the bottom of the income scale. Modern fiscal arrangements, like those of medieval barons, must be explained largely in terms of efforts to grab funds wherever they could be reached with least difficulty—to levy upon trade wherever tribute could most easily be exacted—and with almost no regard for consequences in terms of either economic efficiency or personal justice.[3]

The problem of stabilization, of maintaining reasonably full employment of resources, calls for emphasis mainly upon two factors, one of which again is monopoly. If all prices moved up and down with substantial uniformity, changes in the general level of prices would have only unimportant effects upon the volume of production or employment. A major fac-

tor in the cycle phenomenon is the quite unequal flexibility of different sets of prices and, more explicitly, the stickiness of prices which, for the bulk of industry, determine out-of-pocket, operating (marginal) costs. This stickiness of prices reflects, first, competition-restraining organization, and, second, a widespread disposition to sacrifice volume to price—which is the characteristic exercise of monopoly power. Decisively important in the total situation is the exceeding inflexibility of wages—the explanation of which would require attention to many factors, of which effective labor organization is but one. To some extent it reflects merely a subtle sort of defensive co-operation among workers to protect themselves in a market which is often only nominally competitive on the employers' side. To some extent it involves employer deference to an attitude of the public, which condemns wage cutting and yet accepts wholesale discharge of employees as unavoidable and unreprehensible. More interesting than the stickiness of wages, if not more important, is the price policy in depression of those basic industries which have long since disciplined themselves along lines now widely approved, against "unfair"(!) competition. Equally significant, or more so, is the depression behavior of railroad rates and the charges in other public utilities subject to government regulation, especially freight rates. At all events, the existence of extreme inflexibility in large areas of the price structure is one of the primary factors in the phenomenon of severe depression. This inflexibility increases the economic loss and human misery accompanying a given deflation, and it causes deflation itself to proceed much farther than it otherwise would.

The major responsibility for the severity of industrial fluctuations, however, falls directly upon the state. Tolerable functioning of a free-enterprise system presupposes effective performance of a fundamental function of government, namely, regulation of the circulating medium (money). We should characterize as insane a governmental policy of alternately expanding rapidly and contracting precipitously the quantity of paper currency in circulation—as a malevolent dictator easily could do, first issuing currency to cover fiscal deficits, and then retiring currency from surplus revenues. Yet that

is essentially the kind of monetary policy which actually obtains, by virtue of usurpation by private institutions (deposit banks) of the basic state function of providing the medium of circulation (and of private "cash" reserves). It is no exaggeration to say that the major proximate factor in the present crisis is commercial banking. This is not to say that private bankers are to blame for our plight; they have only played the game (and not so unfairly, on the whole) under the preposterous rules laid down by governments—rules which mean evasion or repudiation by governments of one of their crucial responsibilities. Everywhere one hears assertions of the failure of competitive controls, of the chaos of unplanned economy, when the chaos arises from reliance by the state upon competitive controls in a field (currency) where they cannot possibly work. Laissez faire, to repeat, implies a division of tasks between competitive and political controls; and the failure of the system, if it has failed, is properly to be regarded as a result of failure of the state, especially with respect to money, to do its part.

We have reached a situation where private-bank credit represents all but a small fraction of our total effective circulating medium. This gives us an economy in which significant disturbances of equilibrium set in motion forces which operate grossly to aggravate, rather than to correct, the initial maladjustments. When for any reason business earnings become abnormally favorable, bank credit expands, driving sensitive product prices farther out of line with sticky, insensitive costs; earnings become more favorable; credit expands farther and more rapidly; and so on and on, until costs finally do catch up, or until some speculative flurry happens to reverse the initial maladjustment. When earnings prospects are unpromising, credit contracts and earnings become still smaller and more unpromising. In an economy where costs (especially wages, freight rates, and monopoly prices in basic industries) are extremely inflexible downward, the deflation might continue indefinitely (until everyone was unemployed) if governments did not intervene (inflate) to save the banks or to mitigate human suffering.

Thus, the state has forced the free-enterprise system, al-

most from the beginning, to live with a monetary system as bad as could well be devised. If, as seems possible, both capitalism and democracy are soon to be swept away forever by a resurgence of mercantilism (by the efforts of persons who know not whither they lead), then to commercial banking will belong the uncertain glory of having precipitated the transition to a new era. Such is likely to be the case, even if our institutions survive this time the attentions of their misguided, if well-meaning, guardians. Capitalism seems to retain remarkable vitality; but it can hardly survive the political rigors of another depression; and banking, with the able assistance of monopoly, seems certain to give us both bigger and better depressions hereafter—unless the state does reassume and discharge with some wisdom its responsibility for controlling the circulating medium.

## PART II

We shall now try to define, for present conditions, the main features of a genuinely liberal program, in the traditional sense of liberalism. Such a program, if it could be realized politically, would suffice to permit tolerable functioning of a free-enterprise system, and to prevent (or postpone) revolutionary change in our whole institutional framework. The time has come (some will say it has already passed) for close co-operation between those interested in making capitalism a better system and those of less liberal persuasion who merely dislike revolutions. Consequently, we hope that the proposals described below may receive consideration, both from liberals who are not naïvely romantic, and from conservatives who are not stupidly reactionary.

The proposals, of necessity, are rather drastic. A liberal-conservative movement must now resist and overcome long-established, cumulative trends; it must set itself against the forces of history. We are drifting rapidly toward political and economic chaos. Consequently, a political movement which is conservative in its objectives must be radical in terms of its means. Those who hope for dictatorship, whether under proletarian or fascist symbols, may rather fittingly refer to us as the impractical visionaries. It is they who may now complacently embrace the faith that what is going to be is good, merely because it so obviously is going to be—in spite of us. The cause of economic liberalism and political democracy faces distinctly unfavorable odds and, therefore, requires above all a strategy boldly and intelligently conceived.

The main elements in a sound liberal program may be defined in terms of five proposals or objectives (in a descending scale of relative importance):

I. Elimination of private monopoly in all its forms

1. Through drastic measures for establishing and maintaining effectively competitive conditions in all industries where competition can function as a regulative agency (as a means

for insuring effective utilization of resources and for preventing exploitation), *and*

2. Through gradual transition to direct government ownership and operation in the case of all industries where competition cannot be made to function effectively as an agency of control

II. Establishment of more definite and adequate "rules of the game" with respect to money, through

1. Abolition of private deposit banking on the basis of fractional reserves[4]
2. Establishment of a completely homogeneous, national circulating medium, *and*
3. Creation of a system under which a federal monetary authority has a direct and inescapable responsibility for controlling (not with broad discretionary powers, but under simple, definite rules laid down in legislation) the quantity (or, through quantity, the value) of effective money

III. Drastic change in our whole tax system, with regard primarily for the effects of taxation upon the distribution of wealth and income

IV. Gradual withdrawal of the enormous differential subsidies implicit in our present tariff system

V. Limitation upon the squandering of our resources in advertising and selling activities

The case for a liberal-conservative policy must stand or fall on the first proposal, abolition of private monopoly; for it is the *sine qua non* of any such policy. Reasonable differences of opinion may appear as to methods; but there can be no intelligent dispute, among liberals and conservatives, as to the objective.

This proposal contemplates deliberate avoidance of the regulation expedient—or, if you please, adherence to the kind of regulation which works only through the preservation of competitive controls. It implies that every industry should be either effectively competitive or socialized; that governments should plan definitely on socialization of the railroads and utilities, and of every other industry where competitive conditions cannot be preserved. On the other hand, it should be a main objective of policy to prevent the development, in

the case of other industries, of conditions which would necessitate political control of prices, or socialization. It must suffice here merely to sketch some of the requisite measures.

There must be outright dismantling of our gigantic corporations, and persistent prosecution of producers who organize, by whatever methods, for price maintenance or output limitation. There must be explicit and unqualified repudiation of the so-called "rule of reason." Legislation must prohibit, and administration effectively prevent, the acquisition by any private firm, or group of firms, of substantial monopoly power, regardless of how reasonably that power may appear to be exercised. The Federal Trade Commission must become perhaps the most powerful of our governmental agencies; and the highest standards must be maintained, both in the appointment of its members, and in the recruiting of its large technical staff. In short, restraint of trade must be treated as a major crime, and prosecuted unremittingly by a vigilant administrative body.

As a main feature of the program, *there must be a complete "new deal" with respect to the private corporation*. As many writers have pointed out, the corporation is simply running away with our economic (and political) system—by virtue merely of an absurd carelessness and extravagance on the part of the states in granting powers to these legal creatures. The following proposals, while tentative in detail and obviously inadequate in scope, will suggest the kind of reform which seems imperative:

I. Transfer to the federal government of the exclusive power to charter ordinary, private corporations, and subsequent annulment of all charters granted by the states

II. Enactment of federal incorporation laws, including among others the following provisions:

1. That no corporation which engages in the manufacture or merchandising of commodities or services shall own any securities of any other such corporation

2. Limitation upon the total amount of property which any single corporation may own

*a*) A general limitation for all corporations, *and*

*b*) A limitation designed to preclude the existence in any industry of a single company large enough to dominate that industry—the principle being stated in legislation, the actual maxima for different industries to be fixed by the Federal Trade Commission[5]

3. That corporations may issue securities only in a small number of simple forms prescribed by law, and that no single corporation may employ more than two (or three) of the different forms
4. Incorporation of investment corporations under separate laws, designed to preclude their becoming holding companies or agencies of monopoly control—with limitations on their total property, on percentage holdings of securities of any single operating company, and on total investment in any single industry (again under the immediate control of the Federal Trade Commission)
5. That investment corporations shall hold stock in operating companies without voting rights, and shall be prohibited from exercising influence over such companies with respect to management
6. That no person shall serve as an officer in any two corporations in the same line of business, and that no officer of an investment corporation shall serve as an officer in any operating company
7. That corporate earnings shall be taxed to shareholders in such manner as to prevent evasion of personal-income tax with respect to undistributed earnings (see below, p. 27)

The corporation is a socially useful device for organizing the ownership and control in operating companies of size sufficient to obtain the real economies of large-scale production under unified management. It should not be made available, however, for financial consolidation of operating enterprises which are (or which, without serious loss of efficiency, might be) essentially independent as to production management. Horizontal combinations should be prohibited; and vertical combinations (integration) should be permitted only so far as clearly compatible with the maintenance of real competition. Few of our gigantic corporations can be defended on the ground that their present size is necessary to reasonably full exploitation of production economies; their existence

is to be explained in terms of opportunities for promoter profits, personal ambitions of industrial and financial "Napoleons," and advantages of monopoly power. We should look toward a situation in which the size of ownership units in every industry is limited by the minimum size of operating plant requisite to efficient, but highly specialized, production —and even more narrowly limited, if ever necessary to the maintenance of freedom of enterprise.

Only a special class of investment corporations should be permitted to hold stock in other corporations; and their powers should be circumscribed narrowly, in order to assure that they confine themselves to performing the important and legitimate functions of the investment trust. These corporations should be merely passive investors, protecting their own stockholders by diversification, rather than by exercising control over operating companies; and full precautions should be taken against their becoming, in effect, holding companies or devices of producer organization.

All corporations should be held to a Spartan simplicity in their capital structures. There should be the sharpest distinction between owners and creditors; and, where this distinction becomes impaired through financial adversity, reorganization should be compulsory and immediate. It would seem wise, indeed, to require the maintenance of a predominant residual equity, and to limit narrowly (say to 20 per cent) the percentage of contractual obligations to total assets.

The establishment and preservation of effective competition throughout the labor market is a difficult and forbidding task. Given real competition among employers, one might wisely advocate application to labor organizations of the general prohibitions upon restraint of trade. If trade unions could somehow be prevented from indulging restrictive monopolistic practices, they might become invaluable institutions. They might then assume their proper rôle as agencies for making labor articulate politically, for preventing arbitrary and oppressive treatment of individual workers, for rendering special services to their members, and for promoting consumer cooperation with respect to both commodities and the various

forms of social insurance. Such policy, however, may seem politically fantastic. The community regards unions as representing the interests of labor generally, rather than as agencies for exploitation within the ranks of labor. Even the weaker groups who largely bear the brunt of such exploitation co-operate with their organized brethren and applaud their conquests.

The best one may hope, perhaps, is that labor monopolies, if not fostered and supported by the state, will cease to grow, and even decline in power. Developments of recent years afford some grounds for this hope. Moreover, if genuinely competitive conditions were established among employers, and if we had an efficient system of public employment exchanges, labor monopoly would probably have to face a more hostile public opinion. Full publicity, through the employment exchanges, as to the numbers of qualified workers unable to obtain employment in various trades would create some pressure, in normal times, against unreasonable wage demands. Greater stabilization of production and employment, under a sound system of money and credit, should eliminate the boom periods in which organization proliferates, and also minimize the need for pressure to overcome the lag of wage rates when costs of living are rising.

One scarcely need remark that the establishment of good public employment exchanges is immensely important, on other grounds, for the strengthening and improving of our economic system.

The proposal for abandonment of the regulation expedient in the case of the railroads and utilities requires little comment here. We can worry along with existing arrangements, to be sure, for a considerable time. It seems imperative, however, that we recognize the inherent limitations of these arrangements and plan toward gradual change. Mere recognition of the ultimate difficulties should help to dissuade us from extending needlessly the range of regulation.

Much can be said for early socialization of the railroads, if only for the training of governments in the discharge of such functions, and for the light which experience would throw

upon the expediency of extending gradually the scope of public ownership. The feasibility of public ownership and operation of the other utilities will vary from locality to locality, according to the efficiency of public administration and the level of political morality. A good case can be made for extensive experimentation, however, if only because the present system of regulation is failing so completely.

The proposals with reference to banking and currency arise out of the conviction that extreme fluctuations of production and employment may be prevented by rather simple (if drastic) measures with respect to money and credit. The proposals may be defined tentatively in terms of the following measures:

1. Outright federal ownership of the Federal Reserve Banks.
2. Annulment of all existing bank charters (as of a date, say, two years in the future), and enactment of new federal legislation providing for complete separation, between different classes of corporations, of the deposit and lending functions of existing deposit banks.
3. Legislation requiring that all institutions which maintain deposit liabilities and/or provide checking facilities (or any substitute therefor) shall maintain reserves of 100 per cent in cash and deposits with the Federal Reserve Banks.
4. Provision during the transition period for gradual displacement of private-bank credit as circulating medium by credit of the Federal Reserve Banks.

   (This implies enormous increase in the investments and in the demand obligations of the Reserve Banks—i.e., long continued open-market purchases which would serve to inject the substitute credit medium and also to facilitate gradual liquidation of the investments of existing deposit banks. At the end of the transition, the Reserve Banks should find themselves in possession of investments amounting to a substantial portion of the federal debt—or, perhaps, in possession of the greater part of the debt itself—thus eliminating the burden of the debt, to that extent, without taxation and without inflation.)
5. Displacement by notes and deposits of the Reserve Banks of all other forms of currency in circulation, thus giving us a completely homogeneous national circulating medium.

(This implies permanent retirement of all U.S. notes ["greenbacks"], all silver dollars and silver certificates, all gold coin and gold certificates, and all national bank notes. Subsidiary silver might be retained [though it might better be replaced by coins of a cheaper and more durable metal]. Monetary gold would be held exclusively by the Reserve Banks, in the form of bars, and utilized only for settlement of international balances.)

6. Prescription in legislation of an explicit, simple rule or principle of monetary policy, and establishment of an appointive, administrative body ("National Monetary Authority"), charged with carrying out the prescribed rule, and vested with no discretionary powers as regards fundamental policy.

7. Abolition of reserve requirements against notes and deposits of the Reserve Banks, and broad grants of powers to the "National Monetary Authority" for performance of its strictly administrative function.

(The foregoing measures contemplate an economy in which the rules of the game as to money are definite, intelligible, and inflexible. They are intended to avoid both the "rulelessness" of the present system and the establishment of any system based on discretionary management. "Managed currency," without fixed rules of management, appeals to me as among the most dangerous forms of "planning." To establish, as part of a free-enterprise economy, a monetary authority with power to alter vitally and arbitrarily the position of parties to financial contracts, would seem fantastic.)

There will be wide differences of opinion as to what the specific rule of monetary policy, within such a system, should be; but this is not the place to discuss the relative merits of different possible rules. Two observations, however, may be submitted dogmatically: (1) That the adoption of one among the several definite and unambiguous rules proposed by competent students is more important than the choice among them. (2) That rigid stabilization of exchange rates on other (gold-standard) countries is totally inadequate and undesirable as a rule of national currency policy. The various rules which merit consideration differ with respect to the amount of change in the quantity of circulating medium proposed. At one extreme is the rule of fixing the quantity ($M$) or the total turnover ($MV$); at the other is the rule of stabilizing

some index of commodity prices. The former contemplates ultimately a policy of balancing federal expenditures and federal tax revenues; the latter would require continuous financing of expenditures (or retirement of outstanding debt) to some extent by mere issue of currency. It is important to consider how different possible rules would operate, given the basic inflexibilities in the price structure; but it is equally important that the rule be chosen with regard for the political possibilities of securing adherence to it over long periods without substantial modification. (The rule must be such that strong sentiments against "tinkering with the currency" can be regimented around it.)

The proposals with reference to banking contemplate displacement of existing deposit banks by at least two distinct types of institutions. First, there would be deposit banks which, maintaining 100 per cent reserves, simply could not fail, so far as depositors were concerned, and could not create or destroy effective money. These institutions would accept deposits just as warehouses accept goods. Their income would be derived exclusively from service charges—perhaps merely from moderate charges for the transfer of funds by check or draft. Given generous co-operation on the part of the Reserve Banks, the deposit banks should be able to offer their facilities at quite reasonable cost to their customers. Incidentally, a good case could be made for extending the facilities of the Postal Savings System for the provision of something like checking accounts.

A second type of institution, substantially in the form of the investment trust, would perform the lending functions of existing banks. Such companies would obtain funds for lending by sale of their own stock; and their ability to make loans would be limited by the amount of funds so obtained. Various types of agencies, for bringing together would-be borrowers and lenders, would of course appear. In a word, short-term lending would be managed in much the same way as long-term lending; and the creation and destruction of effective circulating medium by private institutions would be impossible.[6]

These banking proposals define means for eliminating the

perverse elasticity of credit which obtains under a system of private, commercial banking, and for restoring to the central government complete control over the quantity of effective money and its value. The success of such measures, to repeat, requires the adoption of sound rules of monetary and fiscal policy, effective administration under those rules, and a high degree of stability in the rules themselves. But no monetary system, however perfectly conceived and administered, can make a free-enterprise system function effectively, in the absence of reasonable flexibility in the price structure—i.e., in the absence of effective price competition among enterprisers and among owners of productive services.[7]

Our proposal with reference to taxation is based on the view: (1) that reduction of inequality is per se immensely important; (2) that progressive taxation is both an effective means and, within the existing framework of institutions, the only effective means to that end; (3) that, in a world of competitive, invidious consumption, the gains at the bottom of the income scale can be realized without significant loss to persons of large income, so long as their rank in the income scale is unchanged; and (4) that drastic reduction of inequality through taxation is attainable without much loss of efficiency in the system, and without much impairing the attractiveness of the economic game.[8]

Taxation must affect the income distribution, whether we will it so or not. Actually, it has operated to increase inequality, except for a slight opposite effect at the upper extremes of the income scale. The proposal here is simply that tax systems be ordered in such a way as to diminish income differences all along the line; that the funds which governments require be obtained through a system of levies which is actually progressive throughout the income scale.

Such a policy requires the establishment of the personal-income tax as the predominant element in our whole fiscal system, and the rescue of inheritance taxation from its miserable failure. The following measures may be suggested as among the important steps in this direction:

1. Elimination of all exemptions of income by kind, establishment

of the tax as a purely personal levy, and clear recognition in the law that the tax is a tax upon persons according to their incomes, not a tax upon income as such.

*a*) Abolition of "tax-exempt securities," and inclusion of all interest and salary items in the calculation of taxable income, whether such items are received from governmental bodies or from private persons.

*b*) Elimination of all special treatment for "capital gains" (and for "capital losses"), but with introduction of rebates under a simplified averaging system, to avoid undue penalty on persons of widely fluctuating annual incomes.

(For example, rebates might be made every five years to persons whose actual tax payments had exceeded by more than 5 per cent what their total tax payments would have been if their taxable income each year had been their average income for the period.)[9]

*c*) Levy upon estates under the income tax with respect to all "unrealized" appreciation of investment assets—i.e., levy of income tax upon the estate just as though the decedent had sold all his property at the time of his death at the appraised value as of that date.

(This would eliminate, except for non-rational behavior, the unfortunate, but exaggerated, effects during booms of taxes upon capital gains. There is now a strong incentive for elderly people to hold on to appreciated investments, merely because the appreciation may be realized without becoming subject to taxation as income *as soon as the owner dies*. This is the rational explanation of why stocks remain in big strong-boxes during stock-market booms—instead of being peddled out to the lower middle class! By such arrangement, moreover, we might eliminate the worst practical fault of income calculation according to the "realization criterion"—i.e., according to the anomalous, but practically useful, rule that "unrealized income is not income until it is realized through sale.")

*d*) Effective provision against evasion of personal-income tax by stockholders with respect to the undistributed earnings of corporations.

(The objective here should be that of taxing shareholders in corporations in exactly the same manner as members of partnerships. This is, perhaps, altogether impractical under existing conditions; but, given the "new deal" proposed above with respect to corporation law, it would be feasible.)

*e*) Provision for inclusion, in the calculation of taxable personal income, of the net use value of all real estate used by the owner for consumption purposes (residence, etc.).

(The unhappy omission of this item is peculiar to income taxes in America. Such income-in-kind must be accounted for if the income tax is to be equitable among individuals. For the best solution, we might well follow the Australian practice of measuring this item of income by taking a fixed percentage (say 5 per cent) of the capital value of the property. This would eliminate the complications of depreciation and maintenance allowances. It would be an enormous improvement over existing arrangements, even if this item of income were measured merely on the basis of existing local assessments of real property.)

2. Treatment of all inheritances, bequests, and (large) gifts *inter vivos* as personal income of the recipient for the year in which received.

(This, a cardinal feature among these proposals, is conceived as the only practicable method of securing effective application of the principle of inheritance taxation—i.e., for successfully avoiding evasion through distribution of property prior to death. Its adoption should be accompanied by repeal of existing inheritance taxes; a case could be made for retention of moderate estate taxes.)

3. Reservation of estate, inheritance, and personal-income taxes for levy exclusively by the federal government, but with provision for generous sharing of revenues with the states.

(One may suggest, tentatively, the return of 50 per cent of the revenues to the states, on the basis of collections—i.e., on the basis of the residence of the individual taxpayers. Herein lies, perhaps, the only real opportunity for eliminating antiquated and regressive elements in our state and local tax systems.)

4. Drastic alteration in the rate structure of the personal-income tax, with more rapid progression, and above all with the introduction of really substantial levies upon the so-called middle and lower income brackets.

(Something may be said for retaining the present exemptions, but in the "vanishing" form—i.e., with the exemptions expressed in terms of amounts of tax, instead of in terms of amounts of income. A good case can be made for requiring every income receiver to file a return and perhaps to pay a small fee. With present exemptions, we should have an initial rate (normal tax) of at

least 20 per cent, and the rates should rise rapidly to at least the present maximum. Whether the rates should be higher in the upper brackets than at present is of minor importance from a revenue point of view. If these heavy levies on middle-class incomes seem objectionable, one should remember that the alternative is the retention, as a major element in the system, of the drastically regressive levies on commodities of wide and general consumption. The really important question, as I see it, is whether government revenues shall be derived largely from the middle class or pumped largely out of the bottom of the income scale by excise levies.)

These proposals look toward arrangements whereby something like 10 per cent of the whole national income would pass, via personal-income taxation, into the hands of government. They contemplate abolition of all excises on commodities of wide and general consumption, and ultimately of the innumerable miscellaneous levies which have no justification in terms of broad considerations of policy. Levies like the gasoline taxes might well be retained indefinitely—being eminently defensible as charges for special services of government to a class (or to a form of consumption) which does not merit subsidy. Taxes upon real property also might properly be retained without diminution of long-established rates. These levies are largely in the nature of fixed charges, representing an established equity of the state in real property. Such property has long been bought and sold subject to the prospect of continued taxation; to reduce the levies would involve a large gift by the community (through increase in capital value) to persons who happened to be in possession at the time.

On the expenditure side, we may look forward confidently to continued augmenting of the "free income" of the masses, in the form of commodities and services made available by government, either without charge or with considerable modification of prevailing price controls. There are remarkable opportunities for extending the range of socialized consumption (medical services, recreation, education, music, drama, etc.) and, especially, for extending the range of social-welfare activities. The prospects in these directions, however, must remain somewhat unattractive so long as the expenditures in-

volved must be covered by the kind of taxes on which we have relied in the past—i.e., so long as what the government gives to the masses with one hand is largely taken away with the other.

Opposition to tariffs is, of course, a cardinal element in the liberal creed. Our tariff system is essentially a system of subsidies financed by means of commodity taxes. The precisely equivalent system of explicit subsidies and taxes would surely look like a monstrosity to every reasonable person—with subsidy expenditures exceeding all other federal expenditures, and with an enormous burden of highly regressive excise levies. Two arguments especially may be urged against our tariff: (1) if we are to have enormous subsidies, they ought not to be borne by consumers in proportion to their consumption; and (2) there is something absurd about wholesale subsidizing of particular industries by the government. An "equitable" subsidy system, whereby every producer group both shares and contributes uniformly, is, of course, merely ludicrous. Tariff subsidies, to be sure, can never be uniform, being available only to producer groups whose products might otherwise be imported; but that only raises the question of why public subsidies should be confined to such groups (and the question of why the inevitable burdens should be inflicted upon producers for export).

Thus, our tariffs serve both to reduce substantially the total of our real national income and to increase markedly the degree of income inequality. But two other points may be especially emphasized here.

In the first place, drastic tariff reduction is an important and perhaps indispensable element in a program for eliminating private monopoly and restoring reasonable flexibility in the price structure. There are technical difficulties, in the case of some industries, in establishing adequately competitive conditions merely within national boundaries. With a high tariff wall, it might be necessary, in order to assure real competition, to enforce an otherwise undesirable smallness of firms which would be quite unnecessary with freedom of importation. Though we do have strong international cartels,

the fact remains that it is much more difficult to enforce price maintenance on an international scale. Moreover, it is difficult to imagine a thoroughgoing political program which undertook to introduce competition and flexibility internally, while freezing the economy against competition from abroad.

The second point has to do with the general argument against public regulation of prices in private industry, and its consequences for political morality and the future of democracy. A nation which wishes to preserve democratic institutions cannot afford to allow its legislatures to become engaged on a large scale in the promiscuous distribution of special subsidies and special favors. Once this occurs, there is no protecting the interests of the community at large and, what is more important, there is no protecting the political institutions themselves. Tariff legislation is politically the first step in the degeneration of popular government into the warfare of each group against all. Its significance for political morality is, moreover, quite patent. Against the tariff, all other forms of "patronage" and "pork-barrel legislation" seem of minor importance.

The way to reduce the tariff is simply to reduce it. There is, to be sure, a decisive case in favor of gradualness. One must recognize legitimate vested interests in even the most objectionable subsidies. An ideal program would call for a continued scaling down of duties, with the announced objective of getting rid of them all, over, say, a ten-year period.[10] If some reciprocal reductions can be obtained from other nations, well and good. But let us understand that, given an independent national currency administered according to sound rules, the gains to this country from reduction of its tariff are nowise conditional upon reduction of tariff duties abroad.

The fifth proposal must be dealt with briefly here, and left somewhat unprecise. It is a commonplace that our vaunted efficiency in production is dissipated extravagantly in the wastes of merchandising. This economic system is one which offers rewards, both to those who direct resources into industries where the indirect pecuniary demand is greatest, and to

those who divert pecuniary demand to commodities which they happen to be producing. Profits may be obtained, either by producing what consumers want, or by making consumers want what one is actually producing. The possibility of profitably utilizing resources to manipulate demand is, perhaps, the greatest source of diseconomy under the existing system. If present tendencies continue, we may soon reach a situation where most of our resources are utilized in persuading people to buy one thing rather than another, and only a minor fraction actually employed in creating things to be bought.

Firms must spend enormous sums on advertising, if only to counteract the expenditures of competitors; and, finally, all of them may end up with about the same volume of business as if none had advertised at all. Moreover, every producer must bribe merchants into pushing his product, by providing fantastic "mark-ups," merely because other producers are doing the same thing. Consumers must be prohibited access to wholesale markets and prices, in order to protect the "racket" of retailers whose co-operation the individual producer requires; and there follows inevitably the absurd proliferation of small retail establishments which spring up to exact on small volumes of trade the large percentage tribute which existing arrangements allow to those who can classify as dealers rather than as consumers. There appears to be no significant limit, along these lines, to the potential accumulation of economic waste; for every producer must at least keep up to the pace which others set.

In these practices of merchandising, moreover, one finds an outstanding incentive to combination and producer organization. Firms acting co-operatively may spare themselves the expense of competitive selling activities; and organization permits of profitable joint enterprise in building up demand for their common product, at the expense of other industries. Thus, organization of competing firms tends to change the form of advertising, rather than necessarily to reduce the total of such outlays; selling activities become competitive among industries instead of merely within industries; the battle of advertising becomes a battle between organized groups, instead of between competing producers of similar commodi-

ties. While organization has little or nothing to offer by way of merchandising economies for the community, it has much to offer to the individual participants. Besides, advertising intrenches monopoly by setting up a financial barrier to the competition of new and small firms. Consequently, an appropriate remodeling of the system with respect to merchandising would do more than free wasted resources for useful employment; it might remove one of the main factors working to destroy real competition in industry.

The reform of merchandising offers immense economic rewards; but, unlike the other proposals, it is not immediately indispensable for survival of our economic and political system. Moreover, there is prospect of substantial and continued improvement in merchandising, even in the absence of any deliberate political action to that end. The unfortunately wide differentiation between wholesale and retail prices, and the sharp separation between wholesale and retail markets, may be regarded as a vestigial remainder of the mercantilist system (as a colossal system of restraint upon trade) which has only recently begun to be undermined. The growth of mail-order houses and of large-scale retailing through chain stores is salutary and (given not too much foolish legislation) abundantly promising—offering great economies through increase in the size of units, and without raising any real problem of monopoly.

Enterprises like Consumers Research, Inc., may represent the beginnings of an almost revolutionary development. We may hope that such undertakings may flourish, and that their growth may be promoted through private endowment. (It is hard to imagine a more worthy philanthropy.) Perhaps we shall see the establishment of endowed, non-profit-making institutions, of unimpeachable disinterestedness, which will offer to manufacturers (freely or with moderate charges) the use of the institutions' certification or recommendation in the labeling of approved products. Ultimately, we may see the labeling and classification of the more staple goods on the basis of Bureau of Standards specifications, so that consumers may know (and insist on knowing) which brands of goods meet requirements for government purchase. Perhaps we may

still hope for substantial development of consumer co-operatives, organized for collective research and consumer education.

Early correction of merchandising evils by restrictive legislation is perhaps impossible; and one resents the conviction that many proposed remedies would prove worse than the disease. The strongest case can be made for heavy taxation of advertising, provided rates can be made much higher than revenue considerations would dictate. There are interesting possibilities in progressive taxes on manufacturers and jobbers according to the percentage of selling expenses to total expenses. The important objective, however, is that of breaking down, first, competitive advertising and, second, the artificial separation between wholesale and retail markets. Consumers should be free to purchase commodities either with or without the services offered by existing retail establishments —just as they should be free to purchase milk, at substantially different prices, with or without doorstep delivery.

Little has been said so far about the immediate problems of the depression. Our first and second proposals indicate appropriate methods for preventing the recurrence of extreme depressions. For the moment, however, attention must be focused on the task of escaping from the present affliction of extreme unemployment and underproduction. Unless the immediate crisis can be dealt with, there is no sense in talking about long-run policy.

The depression is essentially a problem (1) of relative inflexibility in those prices which largely determine costs, and (2) of contraction in the volume and velocity of effective money. The crucial characteristic of the situation is maladjustment between product prices and operating costs; and, given this condition, there is no necessary limit to the possible deflation and decline of employment. Sound policy will look, first, toward pulling the more sticky prices down and, second, toward pulling the flexible prices up, in order to create favorable prospects with respect to business earnings. Little can be accomplished quickly in the first direction; consequently, main reliance must be placed on "reflationary" government spending.

Inflationary fiscal policy is dangerous, to be sure—but not so dangerous as the alternatives. It should be undertaken with definite preliminary announcement of an objective, stated, perhaps, in terms of *moderate* increase in a specified price index. The program should be planned with an eye to maximum flexibility, for prompt attainment of the price-level objective, and to assure checking of the inflation within the limits designated. Measures of this kind must be undertaken, merely to keep running a system which banking and monopoly have brought to its present plight.

Such a program contemplates bringing the more flexible prices back into line with the prices which prove most resistant to downward change (freight rates, prices of steel rails, electrical equipment, and aluminum, wages in strongly organized trades, etc.), and it looks toward general increase in the volume of production. If the prices which have been most inflexible downward prove highly flexible in an upward direction with inflation, the whole undertaking will fail calamitously. While there may not be much which governments can do to bring the relatively high prices down, it is the supreme folly of a recovery program to facilitate their increase. If the uncompetitive prices are pushed up continually with inflation,[11] the effects of the stimulant will be counteracted, and more and more inflation will become politically inevitable. No diabolical ingenuity could have devised a more effective agency for retarding or preventing recovery (or for leading us away from democracy) than the National Recovery Act and its codes.

It is easy to devise phrases for denouncing the Roosevelt program and the so-called New Deal. On the other hand, one hesitates to condemn, knowing that condemnation will invoke applause from persons whose political philosophy has nothing in common with one's own. Moreover, one hesitates to alienate that now large group of earnest persons with whose general purposes and aspirations one has the deepest sympathy—whatever one may feel about their conception of means to the ends on which it is so easy to agree.

One cannot criticize the policies of the present administration without seeming to approve those of its predecessors. In

fact, one must condemn the Democrats mainly for their wholesale extension of the worst policies of the past. The N.R.A. is merely Mr. Hoover's trust policy and wage policy writ large. The agricultural measures and many other planning proposals are the logical counterpart and the natural extensions of Republican protectionism. The gold policy and the silver legislation, like the Federal Reserve System, lead from a bad monetary and banking system only into something worse.

There is little point, however, merely in condemning particular measures and proposals. Real negative criticism must be judged in terms of, and will be significant for, the critic's conception, express or implied, of sound policies. In these pages we have tried to express criticism of current trends in economic policy in terms of definite specifications for a sound liberal program. For those who accept understandingly the position here outlined, it would be gratuitous to point in detail to the dangers of the spuriously liberal proposals which receive the benediction of our political leaders and journalist-economists; and for others, it would be pointless indeed.

The program here outlined should afford adequate outlet for all the enthusiasm and genuine idealism which might now be canalized so effectively. It seems drastic enough to satisfy the most ardent reformers; and it offers abundant opportunity for real economic planning. There is the whole field of transportation and public utilities for the gradual expansion of government enterprise. Competition enforcement and the reform of merchandising call for a generous measure of government control over private business. The designing and building of a mighty engine of income and inheritance taxation is an undertaking big enough and hard enough to occupy the capable people who are really concerned about inequality. There are endless possibilities for increasing and improving the community's "free income" in the form of governmental services, especially through extension of social-welfare activities. Finally, and perhaps most difficult of all, is the task of constructing a sound monetary and banking system.

There cannot, of course, be general agreement in detail on the measures here proposed. No reader is likely to find all of

them acceptable. (I must confess to serious misgivings myself at many points.) However, it has seemed desirable, if only for conciseness, to define problems in terms of possible solutions, and to define the general objectives of a liberal policy in terms of fairly specific measures. We hope that there may be agreement, within a significant group, on these general objectives; and that, starting from such agreement, we may be able to formulate specific proposals which are less inadequate and less ambiguous.[12]

This tract is submitted in the hope of promoting a concensus of opinion within a group which might now perform an invaluable service in intellectual leadership. The precious measure of political and economic freedom which has been won through centuries may soon be lost irreparably; and it falls properly to economists, as custodians of the great liberal tradition out of which their discipline arose, to point the escape from the chaos of political and economic thought which warns of what impends.

# NOTES

1. The reference here, of course, is merely to that kind of planning which, like mercantilism, implies elaborate regulation of trade, both foreign and domestic, and extensive political control of relative prices, relative wages, and investment.

2. It is, perhaps, easy, from this general viewpoint, to see both advantages and serious practical difficulties in the development of labor organization along industrial, as against occupational, lines.

3. For the disillusioned economist-liberal, a certain bitter satisfaction may be found in the spectacle of capitalism, and the whole institution of property, collapsing under the feet of distinguished propertied gentlemen addressing their brethren on the remarkable virtues of the sales tax.

4. The essential practice of modern banking is that of maintaining obligations payable on demand, or on short notice, while holding "cash" amounting to only *a small fraction* of those obligations.

5. It will be necessary to revise notions commonly accepted (especially by courts) as to the maximum size of firm compatible with effective competition. The general rule and ultimate objective should be that of fixing in each industry a maximum size of firm such that the results of perfect competition would be approximated even if all firms attained the maximum size. One may suggest, tentatively, that in major industries no ownership unit should produce or control more than 5 per cent of the total output. Any such rule, of course, raises the difficult question of what is "a commodity"—of how industries or significant classes of commodities should be defined. A period of several years should be allowed for orderly readjustment, the full restrictions coming into effect only gradually. Special arrangements would be necessary, of course, in the case of new industries and new products.

6. It should be clear that *the measures here proposed have no affinity whatever with schemes for socialization or nationalization of banking.* Indeed, they contemplate a financial system under which there would be the least danger and the least occasion for government control over the lending function, i.e., over the allocation of investment funds. One of the great faults of the present banking system is that it is peculiarly exposed to socialization, merely because of its instability. If we could isolate the lending and investment business from deposit banking, we might eliminate a real danger of government control or socialization in an area where it is most important to avoid it.

7. Any treatment of the problem of monetary and banking reform, within space limits appropriate to this tract, must suffer from serious omissions and oversimplification. Correction of these faults would require extended discussion of the following considerations, among others:

*a*) There is likely to be extreme economic instability under any financial system where *the same funds* are made to serve at once *as investment funds for industry and trade* and *as the liquid cash reserves of individuals.* Our financial structure has been built largely on the illusion that funds can at the same time be both available and invested—and this observation applies to our savings banks (and in lesser degree to many other financial institutions) as well as commercial, demand-deposit banking. Thus, any reform which dealt merely with demand deposits and checking accounts might largely fail to accomplish the results intended—might lead, indeed, to a merely nominal transformation of demand deposits into the savings account form.

*b*) A major source of instability is also to be found in the widespread practice of borrowing at short term. Most of the capital requirements which are met by such borrowing are of a permanent, continuing character. Indeed, under modern conditions there are few types of enterprise where funds, once invested, are or can be promptly disinvested again, in the ordinary course of business. The existence of a large volume of short-term commercial debt is thus peculiarly inimical to stability, since any general demand for repayment forces industry into an effort at liquidation which cannot succeed and cannot fail to produce serious disorder. Short-term debts, moreover, are, like time deposits, closely akin to money and demand deposits, since they provide in normal times an attractive and effective substitute medium in which the liquid "cash" reserves of individuals may be held.

In the interest of economic stability, it would be desirable to bring about conversion of all investment (property) into the residual-equity form. A large volume of contractual obligations, with maturities, is inherently dangerous in an economy where orderly liquidation on a large scale is simply impossible. But the problem of long-term debt is less serious. Adequate reform of our monetary and financial system does call, however, for the sharpest separation between money and money substitutes, on the one hand, and investments, on the other—between debts which are regarded as convertible into money by demand upon the debtor (or by refusal of renewal), and debts which may be realized upon only by sale to third parties. It is the rôle of banking, and of the Federal Reserve System especially, to obscure this distinction.

*c*) Effective administration, through a monetary authority, of any sound rule of monetary policy would be impossible apart from the closest co-operation, on the part of the Treasury and Congress, with respect to fiscal practices. Ultimate control of the currency (and the banks) lies in the management of government expenditure, taxation, and borrowing; and the establishment of a separate monetary authority implies a division of powers which would be workable only with thoroughgoing co-ordination and co-operation. Every change in the relation between taxation and expenditure, in either the amount or form of the public debt, and even in the character of tax levies, has monetary effects of first magnitude. Thus, specifications for sound monetary and banking reform cannot be drawn without reformulation of the whole problem of government finance. Monetary policy must ultimately be implemented through fiscal arrangements.

8. Some students would justify the reduction of inequality on the ground that it is essential to the political stability of the system; others, on the ground that it is important for the reduction of unemployment and for the mitigation of industrial fluctuations. The former position, while tenable, involves an unhappy confusion of means and ends. The latter, in my opinion, is open to the same objection, and also to the characterization of completely spurious economics. Moreover, the methods proposed by exponents of this now widely accepted position (widespread unionization, reduction of hours, and increase of wage rates *in a depression*) are the immediate occasion for the assertion that progressive taxation is the only effective means for improving the distribution of income.

9. Considerations of equity clearly demand provision for further rebates in the more extreme cases, especially where persons pay large income taxes and later lose practically all their income and property.

10. It is worth noting that the recent sharp reduction in the gold value of the dollar is likely to create the ideal conditions for (and, internationally, the necessity of) gradual, continued tariff reduction—and, thereby, for raising the prices of export products, notably cotton and wheat, *relative* to other prices.

11. The recent phenominal rise in building costs, with almost no building going on at all, is a case in point.

12. There remains one point which has not been properly emphasized, namely that genuinely liberal reform must aim primarily at explicit changes in the rules of the economic game and must minimize reliance on control or regulation through nominally administrative bodies with large discretionary, policy-determining powers. The point has already been noted with respect to monetary and banking reform; but it is of decisive importance in many other fields. There is now profound significance in the distinction between a government of men and a government of rules; and to the extent that we move toward the former we are accepting or inviting fascism. One highroad to dictatorship lies in the creation of a large number of petty, specialized authorities in particular fields. For an old-fashioned liberal, it is terrifying to reflect on the amount of arbitrary power which has recently been delegated to the President, the Secretary of the Treasury, the N.R.A., the A.A.A., the R.F.C., the S.E.C., etc. However reasonable this expedient in an acute emergency, we must face the fact that emergency measures are unlikely to prove entirely temporary, and also the fact that we were making substantial strides in this direction long before the emergency arose.

A substantial measure of administrative discretion is obviously essential to good government; but it must be economized. If large latitude must often be allowed in the administration of new reform measures, we should seek afterward to reduce the powers of the administrative authorities as rapidly as experience provides the basis for more definitive legislative rules.