

MAINTAINING A STRONG DOMESTIC ECONOMY

27 November 1953

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INDUSTRIAL COLLEGE OF THE ARMED FORCES

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COLONEL BARNES: Admiral Hague, General Greeley, General Hovey, and gentlemen: Today's lecture is another of the vertical program series designed to bring you general background information. It is going to deal with problems involved in maintaining a strong American economy under present world conditions.

Our speaker, Dr. Emerson P. Schmidt, practically lives with these problems on a day-to-day basis. In his work as Director of Economic Research for the United States Chamber of Commerce, he is constantly being reminded that national security today, free world security even, depends largely on the strength of our own economy. So we have asked Dr. Schmidt to come over here today--incidentally, he is giving up a holiday to do so--and draw on his experiences and studies to give us some of his findings on what it takes to adapt our economy to these new demands of free world leadership.

This is Dr. Schmidt's fourth lecture at the college. Many of you also are indebted to his son, Dr. Wilson Schmidt, for a very splendid series of conferences in economic theory last September.

Dr. Schmidt, you can see that we are leaning pretty heavily on the Schmidt family this year. We welcome you back. I am glad to have the privilege of presenting you to this class.

DR. SCHMIDT: Admiral Hague, Colonel Barnes, and gentlemen: It is a real pleasure to come back here and discuss this important subject. I don't know of anything that is more important. Referring to Colonel Barnes' comment, it is a particular pleasure in the light of a very gracious thing that you did when my son was here last summer. At the end of his series with this group, somebody got up and read a long resolution--"whereas," "whereas," and so on--saying in spite of his tender years how much you enjoyed his working with you. So that makes it doubly pleasant to be here. A father is always glad to see his son get along in this world.

I think it was on 5 January 1951 that I discussed this same subject, under a slightly different title, but almost identical; namely, "A Strong Domestic Economy--our First Line of Defense." In a world of international conflict and tension, this topic, of course, cannot be overemphasized. I happened to have the privilege of attending one of the very first briefing sessions in the Pentagon after the Korean War broke out. General Marshall addressed us, a group of businessmen; and he put tremendous emphasis on that theme. It went over very well with the businessmen who were responsible for conducting the American business units.

Now, what do we mean by "a strong domestic economy"? If we could today, it would be interesting to take out time enough to let you each write a short paragraph on what you mean by "a strong domestic economy." But for the sake of brevity I will emphasize two things.

First, a strong domestic economy involves a sustained high level of production, constantly adapted, and readapted, to the changing civilian needs, the military needs, and our international needs. Second, a strong growth factor. I am going to talk a good deal about this growth factor, but I am also going to come back to the question of economic stability, because there is some concern that we may be moving into a depression.

Growth cannot be overemphasized. We will add in the current decade about 28 million people to our population. That is roughly the equivalent of two Canadas; and Canada is, as you know, no mean country.

If we just maintain our present constant level of output, with this rising population you will see that automatically that would involve declining per-capita standards of living. Or suppose that our economic growth only keeps pace with our population growth, then we are merely holding our own. We are not improving the well-being of the American people, their satisfaction and contentment. The feeling that we are living a little better this year than last year, and a little better prospect for next year than this year, is essential for maintaining domestic tranquillity and the political solidarity. Thus we need economic growth exceeding the population growth, so that we can have a rising standard of living; and so that the prospect of living a little better next year than this year is one that all of our people can look forward to.

What are the foundations of growth? What are the essentials for sustained high-level production? If you can answer those two questions intelligently, persuasively, you are pretty good. You are a good economist. If you can go a step further and help implement the policies which are essential for maintaining a reasonable rate of growth, exceeding the population growth, and for maintaining general economic stability in our economy, you are a doubly useful citizen. And, as I understand it, that is one of the things that you are trying to do here at the college.

Let me raise another question. Are these two goals--the goal of growth and the goal of stability--compatible? Or are they incompatible? And, if so, to what degree? Or, to make it concretely, can we go through a period of highly artificial stimulation of our economy, such as we have had in the last three and a half years since Korea, through all sorts of props that the Administration and the Congress have provided for expanding plant capacity and for expanding our whole industrial base, our military potential, and so on--can we go through that hot-house type of growth and then expect to be able to avoid a relapse?

Or is it simply inevitable that, when you go through a period of artificial stimulation, artificial growth, we have the hangover of the night before? Are we currently facing a recession? Is the boom over? Have we generated such enormous incomes of businessmen, farmers, workmen, and nearly everyone, due to the fact that we were not only producing for our current consumption, but we were also augmenting our basic capital structure--steel plants, aluminum plants, and all the other things which generate income, give people purchasing power; and now that we are approaching the end of the great military-industrial base expansion program--which is roughly true in steel, and will be true in aluminum perhaps next year, and is true in some other lines--are we therefore headed for a major readjustment, or, if we want to use a rougher word, a depression?

Before getting into this question of how we can maintain economic stability, let us take a look at growth. What makes for growth?

It is very easy to dry up the springs of growth and expansion and progress without ever knowing precisely what happened. For example, can you put the finger unfailingly on the moments, or the times, or the events, that powered the decline of the British? The British now, unfortunately, are a second-rate power. They are not in the top two. Perhaps they are not in the top three. In other words history records numerous rising civilizations and nations. Britain rose to the highest point, and then it has declined. Historians have struggled for years to find out what makes nations rise and what causes their decline.

This is terribly important in the kind of international world in which we live. If we go into a decline, if we lose our tremendous dynamism, we will not stand a chance of survival. Tragic as it is, it is also important to recognize frankly that we have lost our first war, or at least failed to win it. That is a new experience for us. Perhaps it is loaded with meaning in the sense in which I am discussing growth. Perhaps there are other adequate explanations.

The London "Economist," which is the most influential organ of opinion in the world, has tried to put its finger on what has gone wrong with Britain. While there are many explanations and many aspects of this, let me read you just a paragraph from a very famous article or editorial which the "Economist" published a few years ago. What this editorial says is not quite so true today, fortunately, as it was then; but the basic problem has not been solved. It is an article called, "The Carrot and the Stick." If you haven't read it, I think you will find sheer intellectual delight in reading it:

"The human donkey requires either a carrot in front or a stick behind to goad it into activity. The whole drift of British society for two generations has been to whittle both at the carrot and at the stick until very little of either is left. It is a passion for equality that has removed the carrot.

The rewards of success have not merely been shriveled; they have been poisoned, since commercial success has been turned, in the eyes of wide circles of society, into a positive disgrace. There is a conspiracy of labor, capital and the state to deny/enterprise its reward.

"The success of removing both the carrot and the stick has culminated in the extraordinary circumstances of today. Shrunken as were the incentives and the sanctions of prewar days, they have now for the time being vanished completely. Nobody gains anything from activity or suffers anything from inactivity. There is hardly the flavor of a carrot or the shadow of a stick. And yet we wonder why the donkey does not break into a trot."

Now, let us see if we can dig a little deeper into the foundations of our civilization and history in America, because it is very important to understand the foundations. If you understand them, other things sort of fall into line. I am going to give you my viewpoint. You may want to challenge me. I hope you do if you think what I say is inadequate, and certainly if you think it is in error.

We have in this country, as you all know, attained the greatest success story in terms of material well-being of all time. Why? Not national resources--China has them. Our Indians had them. It is not our technological system. Russia has the same technological system as we have. We have combined in a unique way powerful forces of growth with the preservation of human liberty. And there is where we differ from the Russians and to a considerable degree from many of the European countries.

The roots of liberty and freedom were deeply embedded in our forefathers. These roots are traced by historians in considerable part, to the Protestant revolution, to the Protestant ethic. A group of left wingers, or socialists--I think they were all socialists--were the first, or among the first, to point out the conflict between early and medieval religion and economic progress. And I am one of those who in no sense wants to sell religion short. I think it is probably still the most powerful motivating force.

So Max Weber, Werner Sombart, R. H. Tawney, and a number of other socialists saw a very close relation between the rise of capitalism and the Protestant revolution. But for some curious reason, they concluded that the problem was not primarily one of production, but, rather, of redistribution. They thought we had solved the production problem, and the only problem was one of distribution. Any good classical economist will disagree with that and will argue that it is at best an oversimplification.

There has been something added to this idea in the last decade or so. I have made some effort to find out what scholars and allied

thinkers are saying, because it has been my conviction for a long time that, as the top leaders go, so goes society. They set the pace. They determine the policy.

The new trend of thought in this direction has quite dispensed with this idea of equality, with this idea of redistribution being the solution to our problem. And the British, of course, are paying very, very dearly for having this ideal of equality, which in many ways is a notable ideal; but if you sacrifice the other ideals that are crucially essential in striving for the ideal of equality, then you may simply be defeating your own purpose.

The new dispensation, the new thought--and this is creeping into the minds of even those American economists who were most opposed to it 10 or 20 years ago--is that a small rate of annual growth, 2 or 3 percent of our production output, persistently raising the standard of living on a broad basis, is enormously more efficient in improving the well-being of the Nation than is any kind of redistribution of existing wealth or income.

The reason for this recognition is that the American economy again in the last 15 years has out-performed the whole world; and it has been done primarily through the incentive system. And, in spite of the New Deal legislation--and much of it was desirable and good--and in spite of the minimum wage legislation, in spite of the Wagner Act, in spite of a 500-percent growth in labor unions since the early thirties, the share of our national product going to labor is today almost exactly identical with what it was in 1935 or 1936. But labor is infinitely better off than it was in the twenties or the first of the thirties, because we have found the secret of growth, or perhaps I should say, rediscovered the secret of growth and progress.

Now, this is so important and is so well recognized by thoughtful people that it needs constant re-emphasis. The latest and a very startling fact is that the Russians themselves have junked and liquidated virtually every other ideal which they argued for, such as whittling away the power of the state, which was Lenin's idea and also the idea of Karl Marx. Ideas like equality, or ideas like "To each according to his ability. To each according to his need"--all of these ideas of the Communists have been liquidated. Why? For one purpose only--economic growth. They have seen the superior importance of an expanding economy, of a growth economy. If growth fails, all else will fail.

If the present rate of growth in the Soviet system is maintained until 1975, the production in the Soviet system, including its satellites, not including China, will equal our level of production if we maintain our rate of growth. In other words the rate of growth of the Russian system is continuing in spite of coercion, totalitarianism, no human liberty, and all the rest. All of these are being sacrificed for growth.

We believe that we have found the secret of combining human liberty and freedom, with all its ramifications, such as freedom of choice, of occupation, freedom of migration, and everything else, with this growth. We think our system is greatly superior. But our system has its sanctions, its prerequisites, its conditions requisite to survive. Take away those prerequisites and those sanctions and the system will not survive.

Martin Luther represented a new disturbance 400 or 500 years ago of the previously established equilibrium of society. He came in with a new form of religious enterprise. Charles Beard, the great economic historian, in one of his books said that if a man died in 400 A.D. and returned to earth 700 years later, he would find much that was familiar to him. Seven hundred years--well, that isn't our society. Something new has been injected into our society, so that even your grandfather, your great grandfather, were he to come back, would find relatively little that was familiar to him.

The Protestant revolution liberated society from its previous stability and composure. It exposed society to all the terrors and delights of change and iconoclasm. Now, once iconoclasm, this critical viewpoint, took over in the most traditionally sacred area of life, once free enterprise, if you will permit me that term, had been successful in religion, which is what the Reformation was, the spirit of innovation appeared in all other areas of life.

In some ways the most important innovation in any society is the idea of innovation itself. This is not something that has been with civilization for a long time. This is relatively new.

The Protestant ethic--and I emphasize the Protestant ethic because it stimulated this innovation; I do not say that it was without parallel in Catholicism in this period, because I think that Catholicism, certainly in this country, has accepted this same philosophy, with some variations, to be sure--but the Protestant ethic emphasized the idea of human life in simple form. You don't have to go through any rigorous and rigid formality. Your conscience is your guide. You have self-responsibility.

Next, it emphasized that the Christian life and the Christian profession is a matter of how you live in the workaday world, rather than merely something connected with a cloister or something having to do with the "hereafter." The Reformation theologians came to emphasize what they called the minor virtues. We do not think of them as minor now; but relative to certain other virtues, such as man's relation to his deity, they are relatively minor virtues. They are deeply embedded in much of western culture, particularly more emphatically in our country than in any other country in the world.

What were these minor virtues? They were thrift, hard work, sobriety, punctuality, honesty, fulfillment of promises, devotion to one's family, and so on. Adam Smith the founder of classified economics wrote the "Wealth of Nations" in 1776. It is still regarded as one of the great books, still used in every major university. But one of the things we sometimes forget is that he was professor of moral philosophy at the University of Glasgow. In other words economics is not merely concerned with dollars and cents and production; it has a much deeper meaning.

This background leads directly into the concept of the American economic system, the free-enterprise system. Any economic system must perform certain basic functions. Somehow the resources--labor, land, and capital--must be combined into producing units. The Russians have their way; we have ours. It must provide, next, for a system under which all productive elements can exchange their products or services against the products or services of others--an exchange system. Finally, it must provide for some type of purchasing power, some kind of claim on the stockpile of production within the year, so that the people can buy back the products produced by their combined effort.

Our system has several essentials--and I have time only to run over them quickly--first, private property; second, the freedom of and the sanctity of contracts. Without these two you could not carry on ordinary business contracts.

The third is freedom of entry; that is, any one of you, or your brother or father, can go into any line of business in which he has ability, talent, and capital.

The fourth is consumer sovereignty. That is, in our society the consumer is by and large the king. To be sure, we kid them a little, we have advertising, product differentiation, and what not; but he has the final decision on what is to be produced. And daily every businessman, under this free-choice-for-the-consumer system, if his product is wrong or his price is wrong, in this alternative opportunity for spending the consumer's income for better, other products, is simply passed by, goes bankrupt, and passes from the scene. That is consumer sovereignty. That is the system that has accounted for our fabulous growth.

The fifth is free and flexible prices. That is, under our system we do not have price fixing. We permit prices to seek their own level. To be sure, we have certain dubious exceptions. In the whole field of agriculture, in certain fields of labor, and now and again in business monopoly, we have attempts to fix ceilings. But largely we have an adaptive process with price and wage flexibility. And, of course, we have an important role for the Government, which we think should be confined by and large to establishing the basis and the rules of the game.

Once you have this set of institutions embedded in people's minds and accepted, and if you have genuine competition, then you have the basic foundations for growth.

A great merit of our system is that every resource, whether it is your service or my service, the services of the farmer who raises chickens, corn, or wheat--those services get evaluated by impersonal market forces by and large. And, because of the free-pricing system, the tendency is for a constant process of economizing to go on. This is an idea that I would like to spend some time on, to show you how it really works; but I will use just one simple illustration. If a farmer is raising chickens and producing eggs, and his business becomes unprofitable, he ceases doing it; nobody has to tell him to cease. He just discovers it himself and begins raising turkeys, or he gets out of poultry and shifts to other livestock, to fruits, vegetables, nuts, or whatever is profitable. So we have a constant process of adaptation going on.

The motivation is essentially the profit motive. You all know that the profit motive has come under a cloud. Somehow it is assumed to be an inferior motive. I have never been able to see why. Is the profit motive inferior, let us say, to the salary motive or the wage motive? The wage motive will cause a man to take a job if the profit motive first creates the job.

But it is far more important than that. The profit motive is the great, powerful tool for economizing the Nation's resources. In this country we have 4 million separate business establishments. Every one is anxious to survive and most of them are anxious to grow. This means that in 4 million separate spots in this country we have somebody who is trying to check costs. And you all know how costs are scrutinized. Whether it is in the family, whether it is in business, or whether it is in the college, pressure for the reduction of costs arises and is always there; and somebody has to be very conscious of costs. The profit motive is the powerful tool in business for getting costs down and for finding better ways of making a given volume of human and natural resources go further.

So we have 4 million business places, and another 5 or 6 million in agriculture, separate places where new experiments may be tried. We have the same number of millions of places where innovations may constantly go on. Every one of these millions of businesses is being tested daily by the free choice of the consumer; and if he doesn't deliver, he simply is liquidated.

I think that is the secret of the success in our system. So, in spite of people calling the profit motive narrow, selfish, and avaricious--maybe it is--it has a great social usefulness. It has great strength for building a sound, strong, dynamic, growing economy. Its strength is that you have millions of separate businesses and budgets where costs are constantly controlled, where people are fighting for

new ways of doing things, better ways of developing new products, in order to get that profit dollar. It is profit that makes this fabulous growth.

Another interesting thing about our way of life--which is not true of the British and the French, or even the Swiss to the same degree to any extent, in fact, only to a moderate degree--is that under our competitive system, any innovation, if it is an improvement, inevitably spreads broadly to all the competitors. For instance, if the Baltimore and Ohio Railroad adopts diesel engines, let us say that cuts freight haulage cost by 10 percent. Soon the Baltimore and Ohio will begin to cut passenger fares by nearly the same amount and take business away from the Pennsylvania and other lines. Then the other lines that don't have diesels will have to adopt diesels. So an innovation that is an improvement tends automatically, without some master plan, without some edict from Washington or the State capital, to be generalized across the economy.

Furthermore--and this is one of the great things about our system, one of the great sources of its strength--under this system there is no way by means of which an inventor, a saver, or an investor or a businessman can keep to himself the benefits of an innovation or cost reduction. In other words these technological gains, under competition tend to be generalized through the price system and through competition to all members of society who are parts of the economic system.

Furthermore, this economic system minimizes coercion. No business in this country has much enduring power over you or me. Under a free-enterprise system we have a multiplicity of businessmen, where you have wide ownership. You disperse power. And one of the secrets of human freedom is the dispersal of power, the diffusion. I think it was Hobbes who said that human freedom depends on the fragmentation of power.

If we leave the economy, business, to the inventors, the draftsmen, the craftsmen, and the workers, as we try hard to do; and then if the Government reserves its energies and its resources primarily to the broader aspects, setting the rules of the game, determining national policy, the major issues, foreign policy, certain minimum internal things, including controlling the money supply, it leads to expertness in the Government. Whereas, if you combine the running of the economy with taking care of political affairs in the Government, with foreign policy and all the other things, you have the Government then getting to be a hodgepodge. You get ultimately a planned society.

Or you can go the route of Russia and get a certain power and drive, but you lose the other great value--human liberty. One of the reasons we don't have to worry too much about a third world war is that the Russians Commissars can't trust their own people in the case of war.

That doesn't assure us that we are not going to have war. But the thing is, so far any desire to start war has been suppressed because the Russian people do not like the Russian system. Therefore the Russians must have laws against emigration and laws against immigration. They can't afford to let their armies spread over western Europe, because of potential wholesale trouble at home. So the Russians are getting one thing which we want and have, and that is a certain kind of growth, a war growth to be sure, at the expense of the average citizen; but they are not getting that happy combination of human liberty, human self-development and freedom on the one hand, and economic progress on the other.

Well, I have spent, I am afraid, most of my time on one concept, on one aspect, of the foundation of a strong domestic economy. What makes for growth? We could spend more time on it. Last winter we got out what we call our "Economics Primer" for use by study groups. I brought along a few copies. You may, if you have to do any teaching, like to look at pamphlet No. 5 called "Progress and Prosperity," in which we go into some of these questions.

We will take just a few minutes on the second essential of maintaining a strong domestic economy. That is, how do you maintain stability or high-level utilization of all our human and other resources? In other words, how do you avoid repeating 1929 and the 1930's? How do you avoid a depression?

I would only like to say, since we want to leave time for discussion, a few words. Here too I have pamphlet No. 6, which we call "Sustaining Prosperity." If any of you think you might benefit by it, it is probably in your library. When the Korean War was approaching its end, we got out this little pamphlet, called "A Program for Expanding Jobs and Production."

There are two things necessary for sustaining prosperity. One is to maintain a high rate of innovation on the part of the businessman. It is not much use for the American businessman to keep on producing the same thing over and over again, let us say, a refrigerator, if all the American families have bought a brand new refrigerator in the last two or three years.

I ran across this little story: A bearded gentleman was standing in his office looking at his sales chart. It showed a high volume of sales in the 1890's. The decline since then was so marked that the trend line was far below the original chart and threatened to go through the floor. He said: "I can't understand it. My company still makes the best buggy whips in America."

We have gone through a terrific program of capital formation. We have augmented our productive capacity in steel, aluminum, and so on by

anywhere from 10 to 20 and in some by 30 percent just in the last three years. In other words we have engaged in plant expansion in these last three years which normally would have been spread over the next 5 or 10 years. So we have our plants in a sense. But the workers who built those plants and the workers who made the materials and the machinery that went into those plants got paid. That created purchasing power for them. That caused them to buy refrigerators, clothing, food, and so on.

If you cut back on this rate of capital formation, capital expenditure, unless you can find ways of reabsorbing these human and other resources that were devoted to this plant expansion, you are going to have a depression. There is just no possibility of avoiding it, so far as I know.

The only real answer from the businessman's viewpoint that I know of is this question of innovation. Stop making buggy whips. I ran across what I think is a very interesting and persuasive illustration, although it is very small in our great economy. It involves the power lawnmower. Prewar, hand-pushed lawnmowers constituted 97 percent of the market. Today hand-pushed lawnmowers constitute only 35 percent of the total market. Prewar we had 6 manufacturers of power mowers; today we have 200.

You could multiply that illustration to include all the things, all the ways of producing things that people really want and are prepared to pay for, things that meet genuine human wants. Even though we have climbed down from the mountain top of building 24 million additional tons of steel capacity since Korea, also aluminum, and all the other things, if we can find this area where human wants are unfulfilled and build products that meet them, that is the best single answer to the fear of depression.

Prewar I suppose nobody would have thought that the average working man would buy a power lawnmower. He does today. Why does he buy it? Partly because it is fashionable. The neighbors have it. Partly because, like all of us, the working man is lazy. Partly because the product has been improved a very great deal from prewar. It is more reliable. Partly because the price is right. Partly because it is fun to run a power lawnmower.

So it is up to the businessman to keep searching out and marketing new products. Unless he does this, we are going to have a depression.

What can be done? Under the New Deal, as you know, we have tried all sorts of experiments--CC Camps, the Youth Program, WPA, PWA--a whole series of them. None of them really worked very well. When the Second World War broke out in 1939, we still had 8 or 10 million unemployed. So we are not too sure what the Government can do in that general area. But there is an area in which the Government has primary

responsibility, that is, monetary and fiscal policy. I have time only to say a word about monetary policy, although I don't want to neglect fiscal policy.

You men have studied economics. There has been discovered in the last decade or so what may turn out to be the most important contribution to economics ever made by any American economist. This discovery indicates--and I want to say this somewhat tentatively, because it has not really been tested--that we have never had a serious, major depression unless we had a prior shrinkage in the money supply, which touched off, or partly touched off, the depression.

You all know from your study of economics that our chief form of money is checkbook money. You all know, although this is pretty complicated, that checkbook money comes into existence by the making of commercial bank loans. When you walk into a savings bank and borrow you are borrowing what somebody else has put into that bank. But when you walk into a commercial bank and borrow money, it is the loan which creates the deposit. It is the loan which creates your checkbook money.

Now, from 1929 to 1933 we allowed bank loans to shrink to a point where we literally lost nearly a third of our money supply. That dehydrated our supply of this essential lubricant--money. That, probably more than any other single thing, explains the depth, the severity, and the duration of the depression of the 1930's.

I am happy to tell you that, in my judgment, it is now the official policy of the Administration--the Treasury and the Federal Reserve System--to do all within its power to prevent that kind of shrinkage in the money supply. Indeed, it is the official policy of these two departments, I have good reason to believe, to do everything in their power to maintain the normal rate of growth in the money supply and to foster a healthy rate of growth.

So, in conclusion, you see how the idea of growth, which is one of the prerequisites of a strong domestic economy, is tied in with the idea of fighting a depression or maintaining high-level employment. Thank you.

COLONEL BARNES: Dr. Schmidt is ready for questions.

QUESTION: Would you give us your viewpoint, please, on the idea, which seems to be current now, that what we need is security for everybody?

DR. SCHMIDT: Well, that is one of the great struggles in all, or certainly the western, civilizations. I have a somewhat heretical view on that.

I think it is due more to the politicians than it is due to our citizens. I could document that, but I haven't the time. But the politicians, unfortunately, have to be elected, and they like to be re-elected. We all, including every man in this room, have some sense of concern about our business, our future, our old age, and unemployment. We all are a little lazy. We all will take a handout if it is not too obviously charity. The competitive struggle is a vigorous one, and there is a lot of economic mayhem in the competitive enterprise system. We don't know whether Henry J. Kaiser will survive in the automobile business; but if he can get some Government contracts, he will take them. As employees, stockholders, and so forth, we are all security-minded. We are also rivalry-minded. How quickly, when company drops in, in the evening, and someone says, "Let's have a game of bridge," do we agree. We like competition. We like rivalry, particularly if it is under control! We don't start playing bridge with just anyone, because he might outplay us.

The problem is to find the proper marriage between rivalry and competition, self-reliance, and so on, on the one hand; and on the other to provide some reasonable minimum layer of security. But the politician seems to be everlastingly up against it. If he can promise the labor leaders security, presumably he is in a better position when he comes up for re-election. So he must have an agenda. He must have a program. Much of what you see in the field of social security comes not from the citizen. It simply is not from the masses. That too I could document. The American Federation of Labor was not for unemployment compensation until about 1931 or 1932. Samuel Gompers, the great labor leader, was opposed to workman's compensation until maybe 1910 or 1912.

These ideas of security and so on came to some extent from the intelligentsia; and then the politicians picked them up. I think it is very important that we have certain minimum standards of security--we are rich enough to do it--but far more important is to retain the incentive system.

Now, you are free to challenge any of my ideas. If you think I overstate or understate the case, don't hesitate to say so.

QUESTION: Dr. Schmidt, early in your address you made quite a point of the fact that liberty was one of the important factors in our growth. I gathered that you felt that a continuation of liberty was essential to our future growth. I think that a number of us have felt that there is less and less of that liberty still existing in this country, due to inability to acquire capital on the part of the average man. It gravitates to those who already have it. Perhaps, if you had had more time, you would have gone on from this suggestion of innovation as contributing to a continuation of our growth and dealt with the place of the individual in that scheme. Would you comment a little on that?

DR. SCHMIDT: Yes. I think I agree fully with what you say. With our present tax load, both on the business units and on the individual, it is progressively more difficult for the man with a new idea, who perhaps at the moment is employed but would like to start out for himself, for him to build up a nest egg of capital, or to acquire other capital.

The corporate tax rate is 52 percent, plus an excess-profits tax of another 30 percent, with an overall ceiling, I think, of 70 percent. Well, when you have a potential tax take of 70 percent, you really can hardly afford to risk your capital, because it is not simply the profit motive that is involved; it is also the safety of your investment, your savings. And, if you can invest your savings in 2- or 3-percent bonds, particularly in municipal tax-exempt bonds, and you weigh that income against the very uncertain income from this new venture, in the face of this tax burden, you can dry up the well of liberty and innovation. I think that is what the London "Economist" was getting at.

I am not sure I met your basic point or the complete point.

QUESTION: Yes. You have summarized it well. My real question was: Do you have any suggestion as to what can be done in this country to meet this situation?

DR. SCHMIDT: I have a very unpopular suggestion. We collect too much of our domestic revenue from incomes and not enough from excise and sales taxes. That is a very controversial question. But an excise tax does not discourage incentives to the same degree that an income tax does.

In Britain they did it even worse than we do. They had a pay-as-you-go personal income tax, collected on a weekly basis. So if a worker was asked to work on Saturday, even at time and a half, he got less for his Saturday work than he did on the average for the preceding days. No wonder they wouldn't work an extra shift.

We are not too far from that kind of situation. When you see the individual income tax going up to a peak, I think, of 92 percent on the top bracket, it just isn't worth the effort in the light of the risks involved. If there were no risk, people would still do it. But if you do something extra, take on another chore, take on a new product, it means that it takes a lot out of your nerves. The new idea may fail. So if the Government takes too much in the face of all the other real costs involved, you destroy the incentive.

So we really ought to move in the direction of shifting over from getting, as we presently do, 80 percent of our Federal revenue from income taxes. I think we ought to move in the direction of raising the share coming from excise taxes.

QUESTION: In view of your comments about the desire for security, parity prices for the farmer, minimum wages, and so on, what is the position of the U. S. Chamber of Commerce on fair-trade-practice legislation?

DR. SCHMIDT: We have never been able to get a policy on that. Our membership is so diverse that we have, so far as I know, never had a policy on that, on fair-trade practices.

I think fair-trade practices, however, are not quite in the same category as some other types of controls, because if I produce a toothpaste and insist on it selling at 50 cents, if I make a mistake in the price of my product and it is not worth 50 cents, I fail. So, as long as we have freedom of entry--I emphasize that because it is a prerequisite in our economic way of life--other people are also free to produce a toothpaste.

So a fair-trade practice law is not, I would say, too damaging. But in some respects it is quite in accord with free enterprise, because, if I make a new product, it is my product. I invented it and I designed it. I can go to my dealers and tell them not to sell it for less than my price, or I won't let them handle it. So if I go to my dealer and say: "This is my product. This is my creation. The price is \$2.50. You cannot handle it unless you sell it for \$2.50," the retailer can either say "Yes" or he can say: "No. I am not even going to carry your line. There are lots of other manufacturers."

So I wouldn't confuse freedom of entry and competition with the evaluation of fair-trade practices. Whereas under farm price control--I have a farm out on the Shenandoah River. It was a tobacco farm 40 years ago; today if I started to raise tobacco and sell it on the market, I would be liable to a jail sentence and a fine. If I were to apply for a tobacco allotment, the privilege of raising tobacco, so far as I know, I would be denied the privilege.

Now, that is not human liberty. In fact that is not quite American. Maybe there are some good reasons for it, but I hope to God it doesn't spread to the rest of the economy.

COLONEL BARNES: Dr. Schmidt, that is all we have time for. On behalf of all of us, I thank you for coming up here on your holiday and for this very interesting and stimulating talk. Thank you very much.

(8 Feb 1954--250)S/gw