III

The Danger in the Mounting National Debt

COMPETENT ECONOMISTS in the field of public finance understand that a nation at war cannot impose the burden of its war on posterity through borrowing from its own people. If the debt is paid by the next generation it is also paid to the next generation. When the bondholders of this generation are dead and so can no longer pay taxes for the repaying of the bonds, they obviously cannot receive the money paid by government to the owners of the bonds.

If, as we carry on war, we of this generation are made to pay for it in taxes, we realize and admit that it is we who are doing the paying and sacrificing. But to those who have not analyzed the phenomenon, it often looks as if, when we lend to the government, the case is fundamentally different. In truth, if we purchase (say) savings bonds from (i.e., lend to) the government for war purposes, we *give up having* the goods we might instead have purchased with the money. Just as if the money were taken from us by taxation, the government spends what we might have spent but now cannot or do not spend. Labor is devoted to producing war materials instead of goods for civilian enjoyment. And, collectively, we do not just defer this spending. We resign it forever. For, collectively, we can never get back, for spending, the money so loaned to the government *except as we pay ourselves back.* My taxes may possibly be used to pay you or your tax contributions may pay me but, counting us all, we repay ourselves. Or else, as said above, if repayment is delayed until this generation has gone, so that the taxes for repayment are drawn from the next generation, then the money paid out in redeeming the bonds (repaying the loan) is paid to the next generation.

The fact that the next generation does not repay this generation but pays itself does not mean that our war imposes no loss on our descendants. Capital has been destroyed when it might have been conserved. Repairs of many kinds of capital have been made impossible. The accumulation of new capital for civilian purposes has been prevented by the needs of army and navy. Instead of capital construction we have had to give ourselves to destruction not only of the products of the labor of the enemy but also of the products of our own labor, e.g., explosives. And so the next generation will find itself less well equipped with capital than it might have been and not able, therefore, to produce goods so effectively. In various other ways, too, progress has been checked and the efficiency of production decreased. But at least the next generation definitely does not lose still further by having to *repay* advances made by this generation.

The Public Debt and the Taxing Power

THE FACT, HOWEVER, that a domestic debt owed by government is, socially speaking, not a debt, has seemingly misled not a few persons into the mistaken view that it is, therefore, not a matter to worry about, regardless of how large it may become. Thus, some of the enthusiasts for government spending in the later thirties and the pre-war forties—and since Pearl Harbor, too—have rather insistently argued that the size of our mounting debt need not be a matter for alarm. What on the side of taxes is outgo, they have contended, is, on another side (the side of the holders of bonds, as such) income. Unless our taxes to pay the bondholders are unduly heavy on the very poor who have not the means to pay, we need not worry at all. What if our taxes are sky high, even, provided they are levied just to pay income to ourselves? And although sometimes John Doe may have to pay very heavy taxes in order that Richard Roe may receive interest on his bonds, what of it so long as John Doe can afford to pay these taxes? If he cannot afford to pay them, we have merely to tax Paxton Poe or Mortimer Moe!

In short, to our "liberals" of (sometimes) collectivist bent, especially if they have dreams of using the taxing power so as to take from some and give to others in the proportions they approve, a domestic debt is, often—or so it appears—no disadvantage whatever.

But although the interest on the debt—and the principal, too—is indeed paid by ourselves to ourselves and although it may seem possible to arrange the distribution of income, by means of taxes, so as to take from and give to whomever we want to, such a debt may still be a very great evil. For in a society in which the production of wealth depends upon the motive of individual reward, the taxes necessary to service such a debt may have serious consequences on productive efficiency.

How shall the debt be paid? Shall it be paid by heavy taxes on capital? But surely a national debt can be so large that the taxes on capital or on the income from capital necessary to pay it—or, even, to service it—might discourage saving and investment and thus gradually decrease the capital equipment which labor must use.

Consider the case of a person who saves and invests $10,000 which yields, before taxes, $700 a year (7 per cent). But taxes take, we may suppose, such a large part of this that he has left only (say) \$50 or \$75 a year. Whether or not he holds any part of the national debt in the form of government bonds and so receives interest payments on this debt from the aggregate of moneys collected in taxes, in any case he has to face the fact that from his new savings of \$10,000 he will receive less than one per cent instead of seven per cent. It is to be noted, too, that whatever the remaining gain which may be hoped for *on the average,* whether less than one per cent or one and a half per cent or two and a fourth per cent, some investors in capital actually lose, i.e., receive less than zero per cent. If, now, most of the gain from *successful* investment of savings is absorbed by government through (say) highly progressive income taxes piled on top of local property taxes, the would-be saver and investor may decide that his risk of loss is not sufficiently offset by the reasonably likely gains to make the saving and investing worth while. (What, indeed, if the taxes become so high as to make the *average* gain from such investing, for many persons, *less than nothing!*) He may, then, either not save at all or simply hoard money—or silver, platinum or diamonds—rather than aid in the construction of productive capital.

The fact that, taking us collectively, the money drawn from us in taxes to pay interest on a gargantuan national debt is in turn paid *to* us as interest on the bonds we hold personally, is irrelevant to the present problem. For the particular individual who saves, and invests in new capital, will be taxed on this new capital (or the income from it or both) equally whether he does or does not own any of the government bonds. And he will receive interest on his bonds regardless whether he does or does not accumulate new capital. If, therefore, his chance of gain from such new capital is greatly reduced by heavy taxes levied to pay interest on the government debt, or to pay off the principal, there seems a reasonable likelihood that he, and others in like case, will save less. When this occurs, the community will have less capital.

Mortgaging the Masses to the Classes

WHAT, NOW, IF THE TAXES to service the debt are levied on articles of common use so that a large part of the burden of the levies falls on the poorest classes of citizens? And what if, as may well be the case, the bonds are owned largely by the well-to-do and by persons of moderate income? Then we have a situation in which the poor are heavily taxed to make possible interest payments to the comparatively prosperous. This has been called "a mortgage of the masses to the classes" and there are some who have rather questioned its desirability.

Or, what if taxes on income from work become so highly progressive as to remove, largely, the motive for acquiring or showing superior efficiency!

It is true that a good deal of revenue could be collected by a tax on the annual rental value of land (whether this could be provided for without constitutional change is not here being considered) and that such a tax neither takes anything from the wages of the poor nor puts any penalty or discouragement on saving and capital construction. But none of the apologists for large government debt, so far as I know, has ever urged this non-repressive tax as a means of paying it off. By implication, we must apparently suppose, they expect such a debt to be serviced—and paid, if ever—by the ordinary sort of burdensome and repressive taxes.

Even, however, if such a debt could be and were to be serviced and paid off wholly through a land-value tax, there still would be the consideration that this would compel reliance on other and repressive taxes for the ordinary expenses of government. With no large debt to be serviced, it should be possible to meet, from the public appropriation of the geologically- and community-produced annual rental value of land a very large proportion, at least, of current governmental expenses. But without greater understanding than is at present found among legislators and publicists, this vast annual fund is not likely to be greatly drawn upon either for the ordinary expenses of government or for paying the national debt.

If a government debt becomes so great that the payment of the annual interest on it makes taxation seem unbearably heavy, legislators may lack the courage—or the rashness?—to levy the taxes required for paying both the interest on the debt and the current expenses of government. Instead, they may resort to payment of part of the heavy total of expenses by increasing the currency. Such currency increase may be entered upon with no very acute consciousness of its effect in raising prices; or, at least, no open admission that this will be the effect. But if the currency increase is substantial, prices will rise greatly, incomes (measured in dollars) will also increase, and the burden of the debt on taxpayers will thus become less.

If government acts wisely in other ways, then it should endeavor to maintain a stable general price level (average of prices). But what if government follows a policy that imposes on taxpayers a tremendously burdensome public debt? What if, too, it establishes minimum wage standards above those that can be met at the prevailing price levels except at the cost of widespread unemployment? And what if, also, it becomes committed—as by state constitutional provisions, so that formal reversal of policy is politically well-nigh impossible—to heavier contributions for old-age pensions, mother's pensions, etc., than can easily be borne by the tax system without danger of political and social upheaval, at any rate when there is a big debt to be serviced? May it not then appear that payment of all the obligations thus assumed, out of new issues of paper money, with a resulting rise of prices and, therefore, with a substantial reduction of the *real* burden, is the only politically practicable way out of the impasse?

To maintain a stable general average of prices, i.e., to see to it that the dollar has the same value or purchasing power from year to year just as we see to it that the yard has the same length from year to year, has been referred to above as a desirable objective of public policy. And this can be done—at any rate much more nearly than it has been done hitherto—by a wise control of the volume of circulating medium.

Crisis Policy and the Public Debt

BUT HERE, WHERE we are concerned especially with the problem of burdensome public debt, I want to emphasize the point that such control of the price level need not depend on or in any way utilize for its accomplishment, an increase in the public debt and a corresponding increase in the burden on taxpayers to service the debt. More specifically, in the operation of the New Deal monetary policies during the depression of the nineteen thirties, there was never a time when it was necessary to increase the interest-bearing debt of the Federal government either to increase the circulating medium or to decrease it. Nevertheless, the debt was increased greatly. In consequence, when we entered World War II we already had a pretty heavy national indebtedness.

One of the ideas of the New Deal in its early days was to promote recovery by having the government borrow and then spend what it borrowed, hiring labor (e.g., through the W.P.A.) and engaging in various kinds of production. In so far as this borrowing was from private persons (selling government bonds to them), the borrowing and spending was of doubtful utility. If Smith has $100 with which he would have purchased an electric refrigerator or a radio receiving set, or would have hired someone to help him build a new garage, and instead he is induced to buy a government bond and the government then spends the $100 in W.P.A. work or otherwise, it cannot be said that there has been an increase in demand for goods or labor. For the government is merely spending what Smith would have spent and giving effect to no more demand for labor than Smith would have given had he not loaned the $100 to the government. Unless the $100 thus taken over and spent by government merely would have been *hoarded* by Smith, the spending of it by government has no demonstrable net stimulating effect.

If, however, the government borrows from *banks* and *if* the banks, having large reserves, thus lend to the government *without lending any less to private business and to individuals,* then there is a clear and definite increase in circulating medium and in total spending.

But this method of increasing the circulating medium is objectionable even to stimulate revival from depression. For it involves increase of the government's interest-bearing debt and the beneficial results desired can be obtained equally well in another way. The earlier paragraphs of this paper have been directed to showing that a large government debt is not a matter to be looked upon with equanimity but may be, instead, an economic calamity. And if it is desired, for any reason, to gain an increase in circulating medium, for example, to counteract an immediately preceding credit restriction that has brought depression in its train, and to promote revival, this can be easily done *without* the government's borrowing from banks. A new and additional issue of paper money, e.g., greenbacks, can be used directly for the desired government spending; or this new money can be put into the banks as a government deposit on which the government can draw checks.

"Oh, but that is inflation," it will be said. As a matter of fact, however, it is no more inflation for the government to issue—and spend—$1,000,000,000 of new paper money than for it to borrow from the banks so as to increase bank deposits by $1,000,000,000 and then spend this $1,000,000,000 by writing checks on it. The increase of circulating medium is no greater in the one case than in the other. For bank deposits subject to check are circulating medium. And the increase of government spending is no greater in the one case than in the other.

"But," it will be said, "we cannot trust our government to issue new paper money lest it issue such money in excess." To which I would say: "Can we, then, trust our government to borrow from the banks, since this, too, may be done in excess and, if so done, is also inflationary?"

The fact is that to avoid the evils of periodic severe depressions and to maintain a reasonably stable level of prices, we must have, somewhere, effective control of the volume of circulating medium. If we cannot hope to trust our government or to have, ever, a government that can be trusted to do this (and, therefore, a public opinion that will consistently allow such a policy) we may well despair of the future of the system of free enterprise.

The Strategy of the U. S. Gold Policy

NOT ONLY DID the New Deal use government borrowing to increase the circulating medium and promote business revival. It used the same device to *hold down* the circulating medium and prevent prices from rising. One is reminded here of the man in Aesop's Fables who blew hot and cold with the same breath (both warming his hands and cooling his porridge by blowing on them). In brief, this story of New Deal policy is as follows:

In the early months of the New Deal we ceased coining gold but fixed its price at \$35 per ounce, the value of gold having previously been \$20.67 in American money. The government undertook to buy at this price of \$35 per ounce all the gold offered and, indeed, required all producers of gold bullion in the United States and all importers of gold from abroad to sell their gold to the Treasury. Individuals or companies needing gold for manufacturing purposes, and banks or others needing gold for export, could buy it from the Treasury (after securing a license from the Secretary) for \$35 an ounce. Such a new and higher price for gold naturally stimulated the purchase of American goods with gold, and billions of dollars worth of gold came into the United States. This gold was paid for by the Treasury with gold certificates to the Federal Reserve banks, thus increasing their reserves (these gold certificates being legal tender but in very large denominations and not, in practice, used for general circulation). The other banks, national and state, whose customers were exporting to foreign countries the goods for which the gold was being exchanged, got increased balances with the Federal Reserve banks (i.e., increased reserves) and, thus, increased lending power. And the exporting customers had, of course, the increased bank balances (or cash) consequent on their foreign sales. In short, although the gold itself was no longer money within the United States and did not circulate as money, the effect of the purchase of gold at the new and higher price of \$35 an ounce was to increase the circulating medium.

In 1933–1936 this increase of circulating medium was a favorable condition for revival from depression, since it promoted increased spending and increased demand for goods at a time when there was idle labor and idle capital which could be employed in meeting the increased demand. Even so, the increase of circulating medium could have been brought about otherwise than by means of the purchase of billions of dollars worth of gold from abroad. Also, it is to be noted that business revival might have come faster except for the contemporary policy of the government, under the N.R.A. and A.A.A., of encouraging semi-monopolistic price increases of manufactured goods, thus tending to keep down demand for them despite the increase of circulating medium, and of endeavoring to decrease output on the farms and so decreasing employment on the farms for tenants and laborers.

But in due time it began to appear that the constant purchase of gold and the paying out of increased circulating medium for the gold, might bring a considerable and an undesired rise in the price level and steps were taken to prevent such a result.

Such a step might have been to cease purchasing gold or, at least, to cease purchasing it at the price of $35 an ounce. A *sufficient* reduction in the price offered for gold would certainly have prevented the gold from coming and so would have ended the payments of billions of dollars of new purchasing power calculated to push prices upward. But the price offered for gold was *not* lowered. The recently adopted price of $35 an ounce semed to have become a kind of *sacred* price, not subject to change, or else it was feared that particular interests, politically powerful, would oppose a reduction in the price of gold lest this reduce slightly the price in dollars they received for goods sold abroad. Nevertheless, it is not advantageous to us, as a nation, to send abroad billions of dollars worth of American goods for which we receive no useful and to-be-used goods in return but only gold to be deposited in a vault at Fort Knox, Kentucky, and kept there indefinitely.

The American Penchant for Borrowing

RATHER THAN LOWER the official price of gold, the Treasury endeavored to *offset* the inflationary effect of the inflowing gold by selling government bonds and by withdrawing from circulation the money—and bank deposit accounts—paid in for them. The purchasers of the bonds, of course, thereby had their available means for purchasing goods reduced. And the checks on the various banks in payment for these bonds, collected by the Treasury through the Federal Reserve banks, reduced the reserves and potential lending power of the banks on which the checks were written. Thus, the effect of the Treasury's purchase of gold tended to be precisely neutralized by its sale of government bonds. This process was referred to as one of "sterilizing" the incoming gold!

In effect, the government paid for the incoming gold—for which it still insisted on paying $35 per ounce—by selling its bonds, i.e., by borrowing at interest. Although any danger of inflationary rise of prices could easily have been met without our assuming an increased interest-bearing debt, that method was chosen. The Treasury could have lowered the price at which it would buy gold. If necessary to sell something, the government might have sold some of its useless hoard of gold or silver or both and retired from circulation the money (or bank deposit accounts) paid in therefor. But none of these policies was chosen.

Borrowing has been a policy followed by the New Deal both to promote business revival and to halt inflation. We have just seen that borrowing (i.e., selling its bonds) by the government may decrease circulating medium and bring lower prices if the government does not spend but withdraws from circulation the money (or bank deposits) it receives; and especially if, at the same time, the banks do not have large reserves and, therefore, have to hold down or reduce their loans to business when collection from them of the checks paid in for the bonds reduces their reserves. Earlier in our analysis we noted that government borrowing might increase the circulating medium, so promoting revival if business is dull but, of course, bringing rise of prices if business is active. But such effects are dependent on the borrowing being from the banks. And they depend on the banks having excess reserves so that they can and do lend more to the government without lending correspondingly less to business. Also, they depend on the spending by the government—and not withdrawing from circulation—of the money or check credits received for the bonds.

One might, indeed, attempt to account for the debt-increasing proclivities of the New Deal on the basis that no other policies were, at the time, politically possible! But perhaps these proclivities are in some degree the consequence of an easy-going acceptance, by New Deal economic advisers, of the notion that a national debt of any size is nothing to worry about if and because we owe it only to ourselves! Conceivably herein is an important reason why the present World War is being financed by the United States so largely through borrowing and so little by means of taxation! And conceivably it will turn out, eventually, that currency inflation is the only practicable escape!

Our citizens have been urged to buy war savings bonds not alone on grounds of patriotism but by claims that they are a good and sound investment. If all funds not thus raised from savings and the voluntary subscriptions of citizens were raised by taxation and if bank deposits subject to check and other circulating medium were *not increased* through government borrowing, then inflationary price rises might be—or might have been—avoided. But in so far as inflation reduces the purchasing power of the money later paid to the owners of savings bonds, it must be admitted that the qualities of the bonds as an investment have been misrepresented to them. Or shall we later make the bonds worth more in purchasing power by having a *deflation* with accompanying depression and unemployment? If, instead, the burden of the debt finally becomes so great as to drive us to still further inflation as the only practicable escape from formal repudiation, what shall then be said of the good faith with which the government has urged citizens to purchase the bonds?

Alas! What looks to the popular and superficial view like the easiest path for a nation, may finally become for the great majority—though a few be able to profit from the general distress—the hardest of all. But how shall legislators and administrators be sufficiently persuaded of this before it is too late?