623 So 7th St.,
Gainesville, Fla.

Senor German Bernacer,
Madrid, Spain.

My dear Sir:

I thank you for your kind remarks and the further explanation of your theories. On the whole I believe that our viewpoints are very close inasmuch as you make a definite distinction between money used for circulating capital as opposed to money used for real investment. The thinking of business men in this country is confused in this regard and it is time that the economists tried to clarify the point.

It should be explained that I am not a professional economist myself but a business man. I became interested in economics some years ago and have made quite a study of it in the area of overall fiscal policy. The diagram is one which I devised in order to explain economic flows to other business men and I appreciate your favorable comments regarding it. I believe that once you understand it thoroughly, it will prove to be in very close conformity to your own theory.

I agree with you that a basically correct theory must be evolved before we can expect further progress through application of known theory to practical finance, but the point I made (perhaps too harshly) was that economists as a group appear to believe that the development of economic theory is an end in itself rather than merely a means to an end. It has been more than 150 years since Adam Smith first began the series of analytical studies of the existing economic structure and it seems to me that in this much time we should have been able to progress beyond the theoretical into the active stage of economic progress. I particularly decry the fact that no means has yet been evolved by the economists for simplifying their work to the point that it becomes understandable and interesting to the layman who must at least accede to the processes which theory suggests and must actually participate in many of them. Economic development seems to take place in a sort of cloistered vacuum and the results, whether good or bad, have no way of finding their way into practical application. I wish that every economist who developed some theory for maintaining a balance between production and consumption at high levels would suggest the fiscal remedies by which the theory could be made to operate in practice.

My own thought is that full employment will result only when the total rate of spending and investment is sufficient to buy into use the product of full employment. The economic system should be a device for maximizing the production and use of economic goods but we have perverted it into a device for maximizing dollar wealth and income. Financial practices designed to maximize dollar wealth seldom, except by accident, result in full production and employment. The standard of living of a nation is measured by what it can produce for itself, less its exports, plus its imports. When its productive capacity is being used to full capacity fiscal methods can offer little or no improvement but in this country we have never reached this level. Our standard of living is far less than could be supported by full production because we will only produce so much as spending will absorb into production, and the financial practices which have become standardized for business and Government serve to reduce the rate of spending to a level which is too low to support consumption of evrything that we could produce. I believe that the diversion of savings into circulating capital is one of the major defects in our system. It serves to reduce the spending which would take goods off of the market without actually increasing the dollar funds available for circulating capital purposes.

The effort to increase the fund of circulating capital without increasing the commercial bank debt of business can only result in deflation. I particularly liked your statement that equilibrium could only be maintained when increases in circulating capital were equalled by an increase in the money supply. this is very important and it is essential that it be understood much more clearly by businessmen.

Our Congress has recently passeda bill which commits the Government to determining the difference between the spending which would normally occur during any fiscal year if left to itself, and the amount needed to provide for the consumption of full employment levels of production. I propose that we use a system of taxation which would drive all current savings which are not immediately reinvested into the purchase of Government securities as a means of evading the impact of the tax. In this way the Government could determine the difference between the current rate of income and the current rate of spending very accurately. The actual rates are not important - it is the difference between them which is important. Once the difference is known Government can try to persuade the public to take such action as would serve to bring them into balance but if this did not produce results it would use taxes and its own spending policies to contrive a balance at the desired level. I am a firm opponent of the thinking which suggests that Government must exercise economy and I maintain that no amount of spending which increases the standard of living can be anything but good.

In the chart which I enclose I have added a pencilled line forming another channel. I propose that income be kept within this channel so that all of current income which was not returned to the spending stream by one of the three usual offsets to savings would be made available for return by Government. I also propose that arrangements be made through the commercial bank system to provide new working capital with so little cost and difficulty that business men would not be tempted to use their own savings for this purpose. I will not go into detail regarding the actual methods but they would include a series of taxes on corporate profits and on individual savings which could only be avoided by disbursement or by investing directly or indirectly in Government securities.

Whether this program would have any application to conditions in your country I do not know. Our problem is to permit the consumption of what we can potentially produce. I believe that the problem in Spain is more to increase production and foreign trade in order to bring a well balanced standard of living at a high level. Very little of our foreign trade is actually necessary to make up gaps in our production and we look at it as a means of increasing business profits. It is a luxury with us, not the necessity which it would be for a nation with a less comprehensive list of domestic products. It is for this reason that I do not include foreign trade in my diagram. I maintain that the attainment of full production is a problem for domestic policies, and that we can take some of our products and trade them for foreign goods with advantage, but that such trade must not be viewed as the method needed to insure consumption of our product.

You comment on my picture of the price level. As an engineer I conceived of the gear relationship between spending and consumption and explain that a shift in the diameter of the price-level gear automatically comes into being in an effort to equalize any difference in the pressure of goods trying to find a sale and the pressure of dollars trying to buy goods. The wage-profit level operates in the same way. Of course there is almost an infinitely varied set of forces operating to change prices, wages, and profits, but they all hinge on the basic fact of trying to maximize money income and at the same time equalize opposing pressures.

I suggest for your consideration a problem which has received too little attention in my estimation. We have allowed ourselves to fall into the practice of using the scarcity of jobs to keep wages at some sort of level, and have used the scarcity

of markets for a competitive system as a means of controlling prices and profits. If we once suceed in operating at full production levels we must devise other controls. The brakes to wages, profits, and prices are actually inefficiencies in our system and in removing the inefficiencies we will also remove the brakes. There is a natural bouyancy to these economic factors. Business men want higher prices and higher profits, and workers want higher wages, regardless of the economic need or whether higher levels will really raise the standard of living. If there is a job for every worker and a market for all production there will no longer be anything to hold down wages, profits, and prices to reasonable and stable levels. Stability is almost as desireable as the actual balance between consumption and full production. Again, the solution must rest in a highly intelligent Government fiscal policy. As I see it Government would build up the spending flow to the point where it would insure consumption of the full employment rate of production at the price level which we wish to maintain. If the price level rises this rate of spending would not insure full consumption and there would be an automatic deflation of prices due to what we would consider as over production. But this would require a more intelligent management of fiscal policy than we have any reason to expect from our past experience.

Prof. Anderson showed me a copy of your book and commented on your criticism of the Keynes theories. I am sorry that I do not understand Spanish but I gathered from his remarks that he does not understand how the system can get out of balance when Keynes says that savings and investment are always equal. Investment in inventories must be considered as economic investment even though it is not deliberate investment on the part of the traders. Their attempt to liquidate inventories then becomes disinvestment, usually at lower prices, and the losses sustained offset a portion of the income produced so that it turns out to be merely a transfer of dollars rather than income. The system will almost irresistably keep itself in balance and maintaining a balance between consumption and production is not the problem. The problem is rather to see that the balance is maintained at a high enough level. Production is always equal to consumption plus investment plus "investment"in inventories. But we must see that the total of these three factors is high enough to insure maximum production. Unplanned investment in inventories can never be considered as a permanent investment for these inventories will be eventually liquidated regardless of the losses which must be sustained.

Please note on my chart another point od interest. The money distributed by business is income as soon as it is distributed but if the spending flow is not equal to the income flow the difference will become a loss to traders insofar as parts of the income payments represent profits to higher tier traders. Thus the national income cannot exceed the rate of spending and investment in capital goods. There is no divergence in our thinking, as you suggest. I merely insert another term to take care of basic inventory increases which I consider in the same light as fixed investment. If Demand equals Income less unspent savings DA, and Supply equals Production less increases in inventories, I do not see how there can be any difference between demand and supply, giving consideration to the facts mentioned above where the actual rate of income is affected by the final prices received. Since I am not a professional economist and confess that I have never studied it academically I am sometimes confused by formal mathematical concepts but I feel that we are in close agreement basically and I will be interested in seeing how your theory is received by Continental economists.

Cordially yours,

John F. Belle