

After the onset of the great depression, John Maynard Keynes took it upon himself to advise America on the proper policy course. It is not well known that Keynes criticized aspects of the New Deal. What he recommended instead, however, might have been even worse.

Who answered Keynes? In England, it was F.A. Hayek. In America, it was none other than E.C. Harwood, founder of the American Institute for Economic Research. His article from January 6, 1934, appeared as a feature in the New York Times. It is reprinted here for the first time.

Dear Mr. Keynes:

Much of your open letter to President Roosevelt, seems so appropriate to be above criticism. In particular, your suggestion that the N. R. A. “probably impeded recovery: coincides with view perhaps more widely held than openly expressed. Likewise, your criticism of the attempt to force up prices through arbitrary depreciation of the dollar will find many sympathetic readers.

Unfortunately, portions of your advice seem somewhat perplexing. It may be well to quote briefly from your letter:

“ . . . , I lay overwhelming emphasis on the increase of National purchasing power resulting from Governmental expenditure which is financed by loans and is not merely a transfer, through taxation, from existing incomes. Nothing else counts in comparison with this.”

No doubt you will agree that when a Government obtains purchasing power by issuing bonds and selling them to the public, the funds involved may come from either of two principal courses.

1. That portion of current money incomes the receivers thereof desire to save and invest, rather than spend for consumption goods.
2. Credit originated by the banking system in the form of demand deposits subject to check, similar in character to the bank credit ordinarily made available to business for commercial purposes in order to represent newly-priced goods and facilitate their distribution.

Merely a Transfer

It is clear that if funds be obtained for Government spending from the first source, the net result is merely to transfer purchasing power from

existing incomes. If the one who chooses to save and invest placed his money in the savings bank instead of buying Government bonds, the purchasing power would probably be used by the bank to buy a first mortgage.

In that case the carpenters and others working on the house involved would actually receive the purchasing power as wages. As you suggest, the amount of purchasing power involved is not increased if it is merely transferred to the Government. Incidentally, you might have added that the Government will probably not use such funds to any greater, if as great, advantage as in the case of private industry.

Apparently you feel the purchasing power expended by the Government should come from the second source mentioned. That would involve origination of purchasing power by the banking system in precisely the same manner funds were created for the Government during the World War. In other words, you appear to favor inflation by the indirect route. However, on further reading in your letter I find the following:

“The other set of fallacies, of which I fear the influence, arises out of a crude economic doctrine commonly known as the quantity theory of money.”

Perplexing Feature

It hardly seems reasonable to suppose that one who so regarded the “crude economic doctrine commonly known as the quantity theory of money” would favor inflation. This is one very perplexing feature of your letter. Apparently you advocate increasing the amount of the purchasing medium in circulation but you feel this does not necessarily raise output and income. The only alternative that occurs to me is that you believe there are stagnant pools of purchasing power which should be in use and which can be drained by selling Government bonds. The question is, where are these stagnant pools and can they actually be drained as you suggest?

I can conceive of two possibilities you may have in mind. Perhaps you believe demand deposits are being hoarded; or perhaps you think hoarders of actual currency would be willing to buy Government bonds.

Demand deposits are not being hoarded. The velocity of circulation compares favorably with that of normal periods of prosperity in the

past, though less than during the 1929 boom, as might be expected. So far as we can tell (the figures are both comprehensive and accurate), there are no stagnant pools of purchasing power in the form of demand deposits. Time, or savings deposits, are merely the record of funds handed to the banking system for investment purposes. There is no stagnant pool of purchasing power in connection with these records of past events.

We have tried to coax currency out of hiding by offering Government bonds of small denomination, without success. In any event, the loss of purchasing power occasioned by such hoardings has been more than made up by Federal Reserve purchases of Government bonds and the issue of Federal Reserve notes.

If you did not believe there were stagnant pools of purchasing power, and merely wished to urge inflation via Government bond issues, you may be interested in the following information:

During the World War the United States chose to inflate rather than pay for materials with current savings plus receipts from heavy taxation. This inflation was accomplished by the origination of enormous quantities of purchasing power, mostly demand deposits, on the basis of Government bonds. The costs of the war were thus tremendously increased and a large burden of debt was saddled on the country.

In 1920 and 1921 there was a period of deflation which largely cancelled or retired from circulation the excess purchasing media. Following that, an orderly readjustment to pre-war relationships might have been expected. However, the Federal Reserve System, through open market operations and by exerting every effort to make credit cheap, made possible nearly a decade of easy money.

Renewed Inflation

From 1922 to 1929, as a result of these policies, there was renewed inflation in the United States. It was indirect, by means of excess investment to money savings, and at the time few realized what was going on. The results have been most unfortunate. Now, it seems to me, you are urging us once more to try the policies which have brought disaster in the past. Near the close of your letter you suggest:

“Could not the energy and enthusiasm which launched the N. R.A. in its early days be put behind a campaign for accelerated capital expenditure?”

This is the program advocated by many of the keenest students of monetary theory in the United States. However, they realize that the proper sources of funds for long-term investment are savings from current incomes. And they realize that savings thus invested do not cause a reduction of consumer buying power, but merely transfer funds to those who will perform the work and are at present unemployed.

It would be an unfair imposition on your good nature to try to cover all aspects of the troubles which confront us. Please accept my thanks, as one American, for the thought and effort you are devoting to our problems. I trust you will have an early opportunity to clarify, for our benefit, the perplexing features mentioned.

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[Col. E.C. Harwood](#)



Edward C. Harwood (October 28, 1900 – December 16, 1980) was a self-taught economist who founded the American Institute for Economic Research (AIER) in 1933. Harwood graduated from the U.S. Military Academy in 1920. He went on to attend Rensselaer Polytechnic Institute (RPI) before being appointed an Assistant Professor of Military Science and Tactics at Massachusetts Institute of Technology (MIT) in Cambridge, MA. While at MIT, Harwood became interested in economics, particularly money-credit problems, and began an intensive study on the topic. With the encouragement of MIT Vice President Vannevar Bush, Harwood founded AIER in 1933 to provide unbiased scientific research to the public on current economic conditions. His earliest publications include *Cause and Control of the Business Cycle* and *What Will Devaluation Mean to You?*