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Book Review: Liquid Claims and National Wealth, By A. A. Berle, Jr. and Victoria J. Pederson

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BOOK REVIEWS

Liquid Claims and National Wealth, By A. A. Berle, Jr. and Victoria J. Pederson. The Macmillan Co., New York, 1934. One Volume, pp. XVI, 248.

As indicated in the preface, this book is simply an exploratory essay originating out of a desire to analyze the quality of ready transferability of claims. The need for such a study became evident when Mr. Berle and Gardiner C. Means were accumulating the material for their book entitled "The Modern Corporation and Private Property," a book dealing with the increase in size of corporations and the separation of management and ownership with the resulting effect upon the individual. In studying the modern corporation structure it became evident that the claims represented by stocks and bonds were acquiring the quality of liquidity through the mechanism of an open market and legislation permitting the use of such claims as backing for currency through rediscount privileges. The major portion of this book deals with the different types of liquid claims and the substantial increase of such claims in proportion to the total national wealth. The book is divided into two parts. The first part is factual dealing with classifications of liquid claims and the amount of such claims in existence in the United States. The second part, which covers only a few pages of the book, deals with the observations arising out of the study of liquidity. The book also has a substantial appendix which gives in detail the methods employed in computing the data used in the book. The appendix is well prepared and would be of much value to a person who is desirous of studying more closely the question of liquidity.

For a person who has been a student of economics the history and analysis portion of the book serves as a review of the essential requirements for liquidity and the different types of liquid claims. Part II of the book deals with the social effect of the increase in liquid claims and the necessity of some method of control that will protect the populace from the erratic fluctuations in price levels caused through their sudden desires to convert liquid claims into cash. The book does promote thought as to the substantial increase in the proportion of liquid claims to national wealth over the past fifteen years and the vulnerability of such an economic structure when the emotional nature of the masses causes them to swing sharply from the position of owning claims to a position of supposed absolute liquidity, that of holding cash. The author offers no solution but does point out this vulnerability and the need of some type of control.

A summary of the material in the book can best be made through reviewing the individual chapters. In the introductory chapter the author deals with the historical growth of man's desire for liquid claims. This desire for liquidity came through necessity as a result of the change brought about by the industrial era. The question of liquidity was not so prominent when an individual thought of his wealth as the possession of land and the ability to derive a living therefrom, but as the industrial era progressed with the division of labor and the necessity of having a freedom of exchange for articles produced, the desire for liquidity increased so as to permit the individual to be secure against change and to permit him to obtain material satisfaction offered by the industrial age.

In the second chapter the author brings out the differences in the types of liquidity as fostered by opposing schools of thought. He terms one of these schools the classical school which believes that real liquidity is based on consumption, that is, that a liquid claim is one upon goods which are moving toward a market. The other group regards liquidity as the ability to sell or shift an asset on relatively short notice. The author uses the rest of the book to draw the distinction between these two schools and to show where the two types of claims fit into the economic picture. The author offers several definitions of liquidity but the one that is in general use today is probably the following: "Liquidity is a quality inherent in an asset or supplied to it by a reasonably stable mechanism of society furnishing reasonable assurance that it can be converted into cash within a period of time recognized by the commercial community in which it moves as reasonably short—the period varying of course to some extent with each kind of property, but never reaching a period much longer than, say roughly, a year."

In the third chapter the author deals with the structure underlying liquidity in which he points out that on the surface claims may appear alike but that their actual liquidity is dependent upon the underlying assets. For instance, a bank deposit is considered to be highly liquid yet the assets upon which this claim is founded may be of varying degrees of liquidity. A portion of the bank's assets are made up of claims such as bonds which are liquid because of an established open market for them or they consist of claims that arise through commercial transactions based on goods in process or inventory, but essentially on consumption goods moving towards a market.

In the Fourth Chapter the author develops a hypothesis of "real" and "artificial" liquidity. "Real" liquidity exists where the asset can readily be converted into cash because it is in the category of goods which, (a) themselves consistently enter into human consumption or use, (b) are destroyed or permanently immobilized through such consumption or use, and (c) are normally replaced by new production. "Artificial" liquidity exists where either the asset behind the claim can not be sold without the intervention of some financial mechanism or where the claim is virtually non-convertible into cash unless some financial device is interposed to "carry" the asset until the demand appears and is made effective. A terse restatement of the material in this chapter is as follows: Liquidity of a claim is predicated upon the exchangeability of the assets underlying such a claim.

In Chapter V the author points out the tremendous increase in the proportion of liquid claims to the total national wealth. The ratio of net liquid claims to national wealth started to increase at about the time the Federal Reserve Act came into existence in 1913. At that time the ratio was 20 per cent as shown by the author's calculations and compares to a figure of 40 per cent in 1930 and 34 per cent in 1933. During this same period the urban population as a percentage of the total population of the United States increased from 48 per cent to 57 per cent. Any relation between these figures rests on pure assumption; the assumption being that urban population tends to have its property in more liquid form than does the rural population. In this chapter the author injects some of the theories built up in a previous book, "Corporations and Private Property," as to the social implications of the divorcement of management and ownership which is essential to the liquidity of the claim.

In Chapter VI the author presents figures as to total outstanding liquid claims in the form of bank deposits and cash surrender value of life insurance with an analysis of the underlying assets behind such claims.

In Chapter VII the author shows the distribution of national wealth according to types of assets. Again he injects the social aspect of liquidity into this chapter as indicated by the following excerpt: "Grant the supreme desirability of liquidity and you presuppose the existence of the corporate and securities market system or something like it but there is something lost as that picture expands. That is the individual. His relation to physical property; or the ownership of so-called liquid property; or, indeed, his certainty of a place in the scheme of it all, diminishes almost to the vanishing point until he reappears again either as the ward of the government through a dole or as a cog in a private mechanism prepared to undertake almost the same responsibility."

In Chapters VIII and IX the author deals with repayment and resale as mechanisms of "artificial" liquidity. Under "repayment" he describes, (1) the use of the Federal Reserve rediscount privilege, which permits the issuance of currency against certain types of claims, (2) the formation of credit pools where the members are ready to loan any one of the members the necessary cash to meet his obligations (the Federal Reserve banks act as a credit pool for the member banks), (3) the use of reserves by the debtor to indicate the ability to meet the claims presented for payment. Under "resale" he describes past and present methods of establishing active markets for claims by artificially creating a demand for them. Examples of such methods are the use of syndicate pools in the offering of securities to maintain a market (at a price) for the securities until they are largely absorbed for investment, and the use of exchanges, commodity and stock, where speculators maintain the "flow" of claims thereby maintaining a limited ready market.

In Chapter X the author presents an excellent historical sketch of the part law has played in developing the "liquidity" of goods. The student of law could well afford to refer to this chapter as a concise history of the development of the law that finally produced the Negotiable Instruments Law and the Uniform Stock Transfer Act. The history of legal negotiability of shiftable instruments representing capital values is just a few decades old, and its real development commences in 1909. This it may be noted, is exactly when liquidity began to expand with some rapidity in the United States.

The author suggests several courses that may be followed assuming that liquidity is to exist in its present proportions or expand still more. Among the possibilities which would have to be considered are: (1) the reorganization of the banking system so that the stream of "real" liquidity and the stream of "artificial" liquidity shall not be confused; (2) the creation of a central bank analogous to a mortgage rediscount bank, or some similar device, to stand as underpinning for the assumed liquidity of our security mechanisms; (3) possibly, a frank attempt to bring the business of stock exchanges more nearly in line with the procedure in bond markets—that is, to diminish their reliance on purely speculative elements; (4) a *laissez-faire* policy relying on a change in public opinion or technical developments in industry to force the bankers to be more cautious in granting loans especially on claims having only the quality of "artificial" liquidity; (5) a diminishing of the necessary area of liquidity, which would involve an endeavor to switch a certain amount of the savings of the country from investment in savings banks, or in withdrawable life insurance, towards social insurance based on stated contingencies.

The book deals with a timely subject, one in which Federal Administration is vitally interested. Mr. Berle has been closely associated with the Administration. His method of analysis should make the book of interest to those who want to theorize about the proposed social security program.

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