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In appearing before the National Industrial Conference Board, it is appropriate that I should appraise the national economic outlook as I see it at this time. As Chairman of the Board of Governors of the Federal Reserve System, I am primarily concerned with banking and monetary problems and with fiscal policies as they affect monetary conditions. I can speak only for myself, and not for my associates on the Board or in the Reserve System, or for the Government. Many of the issues which I must touch on in order to present a rounded picture of present and potential problems as I see them are by their nature highly controversial. I wish to indicate my own views as frankly as possible for what they may be worth as a part of the full consideration and discussion that are required by the gravity of the times and the importance of the problems before us.

Underlying my approach to all of these problems is my belief that democracy and the system of free enterprise can function to provide reasonably full and sustained employment for all of our available man power, in peace as well as in war times. The great bulk of that employment is and must be provided by private enterprise. Public policy, therefore, should be directed to creating an economic climate that will give the greatest possible encouragement to private initiative and private enterprise that is consistent with orderly and continuous national progress.

The experience of the past decade has served to confirm my conviction that having given this encouragement to private activity, Government should assure employment on useful public works, on a basis that is noncompetitive with private industry, for those able and willing workers whom private industry is unable to employ. Far from being wasteful, that is the essence of conservation for it means adding to the store of national wealth, in providing roads, schools,

hospitalization, public housing, and other betterments, that private enterprise does not and cannot be expected to provide. We gain all these things instead of irreparably losing the product of labor by keeping it idle. Such a policy is economically sound, and when supplemented by an adequate social security program of pensions, public health and relief for the unemployables, compensates for the loss of buying power when the expenditures of private enterprise decline. This in turn benefits private business and restores national income and national revenues.

While fundamental principles of Government policy do not change, policies must vary as economic conditions change. Policy that is appropriate to a period of deflation and under-employment is not appropriate for a time of full employment and the inflationary possibilities that then arise. At a time when activity is rapidly expanding, and we are approaching conditions of reasonably full employment, the fiscal and monetary policies appropriate to the depression period need to be altered to fit the changed conditions.

A condition of rapidly expanding employment and production has ^{now} begun to develop, primarily as the result of our vast defense effort and ~~its~~ ^{British purchases and their} stimulative effects, both directly and indirectly, on the entire economy. I wish now to discuss what seem to me to be the major factors, in the light of present conditions, that should be taken into account as they affect the banking and monetary field, the budget and taxation.

We are again hearing much about the dangers of inflation. It is vitally important to face the inflation issue squarely, but it is also important not to become mere inflation alarmists. We have had too much loose talk about

inflation for seven years. First of all, we must distinguish between a price inflation due to non-monetary causes and one resulting from monetary causes. I have several times in the past defined the latter as a condition arising when the means of payment in the hands of those who will spend it increases more rapidly than the production of goods. This means that the economy has reached the limit of its ability to produce, that is to say, full employment of its man power and productive facilities, but that, nevertheless, the creation of money continues, uncontrolled and unchecked. A price inflation, due to non-monetary causes, arises when production in particular fields is ~~deliberately~~ interrupted or curtailed, whether from bottlenecks, short-sighted wage and price policies, monopolistic practices by capital or labor, or related causes, when there is pressing consumer demand for the goods produced in these fields and when there is neither a shortage of facilities that exist or can be constructed or a shortage of man power. The cure for such a condition is not less, but more production. It cannot be remedied by monetary means *cost of restricting the entire economy except in the*

~~Such a price situation began to develop early in 1937 and I pointed out then that the proper remedies did not lie in the adoption of restraints through monetary action, because such action restricts the entire economy, but did lie in special measures directed at certain unhealthy price and wage increases due to bottleneck conditions and monopolistic practices. The immediate inflationary danger that confronts us is of this character, and must be dealt with promptly and effectively, preferably by self-discipline of both capital and labor in the affected industrial fields which are those on which the defense program is primarily concentrated. The longer-range danger, that of a monetary~~

~~inflation, will not arise until we have reached the limits of full use of our man power and productive capacity. We must be prepared to apply at such a stage effective taxation and monetary controls.~~

The immediate danger is that the upward spiral of prices in particular sectors of the economy will throw these sectors out of balance with the rest of the economy, to the detriment especially of agriculture, unorganized labor and both the low income and fixed income groups. Since our major objective at all times, and especially when we cannot afford to lose time in building our defenses, is full production and employment, it is essential in the general welfare that business and labor avoid strikes and lockouts that interrupt the flow of production, and likewise avoid price and wage policies that induce forward-buying and inventory bulges due to fears of higher prices.

It would be best for all concerned if through self-discipline capital and labor prevented these abuses from developing, but if they fail to do so, *regulation by Government will be necessary* ~~then they invite the inevitable alternative of direct Government intervention.~~

Through increased efficiency and operating for longer hours, capital and labor can increase production. To avoid bottlenecks due to skilled labor shortages in certain fields, it will be necessary not only to utilize existing skills as fully as possible by working longer hours, but *also to* ~~at the same time~~ ~~we should~~ increase as rapidly as possible vocational and apprenticeship training. In these ways bottlenecks and unwarranted price rises can be avoided. Otherwise, governments have no choice, as we have seen in other countries, except to intervene directly by enforcing priorities, by ~~prohibiting~~ strikes and lockouts and by fixing prices as well as wages and hours.

Preventing

These are vital considerations at this time when production must not merely be sustained, but must be greatly expanded to provide defense requirements and at the same time take care of normal civilian needs. I do not think it possible to over-emphasize the evils in the kind of inflation originating in what essentially are monopolistic practices either by capital or labor. The result is not only greatly to increase the cost of defense as well as the general cost of living, but the need to redress the unbalanced conditions that inevitably follow calls for increased subsidy payments to agriculture and increased payments in pensions and relief for the aged and the unemployables in order to try to make up for their diminished buying power. Likewise, it leads to demands on the part of all who are employed for increased wages and salaries to help them meet the increased cost of living. The result is the familiar general upward spiral of all prices which in the end benefits nobody, ^{and} ~~but~~ defeats the essential national purpose of substantially full employment and production for defense as well as for civilian needs.

I am aware that some men in business and in the ranks of labor feel that they should be allowed to make up now for some of the lean years. ~~Yet they cannot do that without inviting the train of evils I have described. Past losses cannot be made up now except at the risk of these inflationary consequences. The price and profit increases necessary to make up for such past losses would have to come out of the economy generally, at the expense of all other groups. That is the path to price inflation which, as I wish to emphasize again, is the most imminent and most urgent condition which we must face and deal with.~~

This problem -- what may be called the bottleneck problem -- requires that now more than ever before we keep a discriminating eye on price movements. Any increase in business activity characteristically produces relative scarcities in certain ^a areas of production relative to the whole. These relative scarcities tend to cause price advances. This is particularly true of a period dominated by defense expenditures. The defense program is concentrated upon specialized sectors of the heavy goods industries. Every effort must be made to increase supply in these areas. To the extent that supply cannot be increased with sufficient rapidity to keep pace with both Government and civilian requirements, priorities and rationing may be necessary as a check upon undue price advances.

There would be no economic justice in permitting the necessities of a great national emergency to yield excessive returns to producers in specialized areas at the expense of the rest of the community. Primary responsibility for preventing the breakdowns, the price distortions and consequences to the entire economy that would result from the attempt to take advantage of the emergency rests upon business and labor leadership. We need above all in this crucial period rapidly expanding production in the industries where preventable bottlenecks are most likely to develop. The time may come when we shall have to curtail private purchases of automobiles and private and public construction in order to give the defense program the right of way in the heavy industries. But priorities and rationing should not be applied until we have exhausted every effort to enlarge productive capacity in the bottleneck areas.

We must also keep a vigilant eye on speculative forward-buying and excessive inventory accumulations. We should be alert to the possibility that the large cash and credit resources available might be turned into speculative channels under the favorable expectations which a prolonged defense program creates. We would be better protected against such speculative inflationary developments if the volume of idle funds already existing were curbed and prevented from increasing still more and if our bank credit structure were again brought within range of control.

What I have been discussing are inflationary conditions due to bottlenecks and other non-monetary causes. Looking beyond these immediate problems, we should be prepared to protect the economy also against the evils of general inflation due to ^{fiscal and} monetary factors.

As the result of gold imports, silver purchases, and purchases by banks of United States Government securities the volume of bank deposits has increased to the highest levels in the history of the country. Demand deposits and currency now amount to \$ 41.5 billions , or about \$ 14.5 billions above the peak of the boom period of the Twenties. At the same time, gold and silver purchases have raised the volume of excess reserves to \$ 7 billions , which is a wholly unprecedented volume, capable of supporting a bank credit expansion of fully \$ 60 billions in addition to the present total of deposits.

As long as these funds have been relatively dormant, they have not presented a serious problem except as they have tended to depress the interest rate structure to excessively low levels. To avoid that extreme --

to keep the bank credit picture within the realm of control that is the special responsibility of central banking authorities -- I advocated, in connection with the Banking Act of 1935, that Congress give the Reserve System adequate powers to absorb the excess, and I subsequently urged that consideration be given to the main causes of this condition, that is, to silver purchases and to the causes of the inflow of gold from abroad which are almost entirely responsible for the present and continuing growth of excess reserves. The authority granted by Congress has been entirely inadequate to cope with the unprecedented growth of excess reserves. For that reason, the Board of Governors as long ago as 1938 recommended in its annual report that Congress take cognizance of and deal with this rapidly enlarging problem.

The need for dealing with it becomes increasingly imperative because of the rapid expansion generated by the defense program. It is essential now that the excess reserves be brought within a range where they can be adjusted to the needs of legitimate business through the open-market function of the Reserve System, and not be left as a basis for an uncontrolled multiple credit expansion such as could be built upon them.

By the open-market function, I mean simply the authority which the Reserve System has to buy or sell Government and certain other securities for its own account, these operations being carried out by the System's Open Market Committee. The importance of these operations lies in the fact that when securities are bought it increases member banks reserves. Conversely, when securities are sold from the open-market account it absorbs and thus decreases

the reserves of member banks. The open-market instrument is a flexible one, affecting only banks that desire to purchase or sell securities, largely in accordance with their reserve position, whereas raising reserve requirements affects all banks in accordance with their classification. I want to say in passing that, contrary to a persistent popular fallacy, the Reserve System does not use reserves deposited with it by member banks to buy Government securities. Such bank reserves are quite literally locked up by the System and cannot be used as a basis for credit expansion. The System has specific authority to create the funds used in open-market operations. These funds are in no way dependent upon or related to such reserves as member banks carry with the Reserve Banks.

~~The Reserve System should be restored to a position in which, through open-market operations, it would be able to expand or contract the basis of bank credit as conditions require, thereby exercising a supervision that is an essential and flexible instrument of monetary control. This the Board emphasized when it succeeded temporarily in placing itself in a position in 1937 where it could make open-market operations an effective medium of control against either an unwarranted contraction or an excessive expansion of bank credit resources.~~

Regaining control over excess reserves is a necessary precaution against the inflationary possibilities of over-expansion of bank credit based upon these redundant reserves. It is not a step that would in any way restrict legitimate business expansion ^{Government financing} or development of the defense program. It is a safeguard against necessary expansion developing into over-expansion -- into creation of the means of payment out of all proper relationship to production.

How this step may best be accomplished is a matter for Congress to determine. However, I see no feasible way to accomplish it except by increasing the reserve requirements of the banks to a point which would reduce the excess reserves to an amount that could be absorbed by the sale of Government securities from the System's portfolio, leaving only enough securities to take care of System expenses. In addition, adequate provision should be made for absorbing future gold or silver acquisitions that add to excess reserves. This power of raising or lowering reserve requirements should be made applicable to New York, the money center, or to all reserve cities, or to country banks, or to any combination of the three groups. This would provide for flexibility and make it possible to adjust reserve requirements *more in accordance with needs.* ~~to conditions that may exist in different regions.~~

Furthermore, reserve requirements must be made applicable to all banks of deposit, whether they be members of the Federal Reserve System or not. It is not equitable to ask only the member banks of the Reserve System to subject themselves to increases when those who elect to remain outside the System, or those who are now members and who choose to withdraw, can escape sharing in what is a national responsibility. This situation is not only inequitable but it renders monetary control ineffective so long as any bank that does not like the reserve requirements can relieve itself of the restriction by withdrawing from the System. Demand deposits are the major part of our money supply -- and control over their expansion and contraction must reach all banks that are in a position to create them.

As long as we have a vast oversupply of excess reserves, the inducement exists throughout the banking system to expand and to put these resources

to work in loans and investments. When the economy is reaching the stage of full production and employment that inducement should be removed.

Not only do the excess reserves afford an opportunity for over-expansion but they also tend to depress the interest rate structure to excessively low levels. I have continuously advocated a policy of monetary ease as the appropriate accompaniment of a period of under-employment, but I have never favored artificially low rates such as have been brought about through an uncontrolled surplus of excess reserves. ~~Such a condition, if long con-~~

~~tinued, undermines our entire debtor-creditor system.~~ No such oversupply of excess reserves is necessary to carry out a policy of monetary encouragement to business recovery. Instead, ~~the~~ excessively low interest rates ^{ultimately} tend to induce inflated prices of Governments, municipals, and other high-grade securities. The effects are reflected in credit lines generally, and are felt by insurance companies, savings banks, educational institutions, and other fiduciaries representing the accumulations of many millions of our people, small as well as large savers. Moreover, this creates a future problem for monetary authorities because at such time as it may become necessary to curtail further credit expansion, as a safeguard against inflationary developments, this step cannot be taken without causing a decline in the price of outstanding securities.

^{Some} Although ~~the~~ interest rate ^{structure} ~~has~~ become ~~excessively~~ ^{extremely} low, rates in the home and farm mortgage field have been relatively slow to respond to the general decline and are not now too low, in my judgment. I think there would be no justification for increased rates on home or farm mortgages, and that

increases in such rates would be unwise and unwarranted. The volume of existing idle funds is so large that some of the higher bond and mortgage rates may go lower even though there is no further expansion of existing funds.

I am concerned with interest rates not as an end in themselves, but as a means to the end of stability in the progress of our economy. Excessively low rates do not contribute to stability any more than do excessively high rates. Neither is fair ~~both~~ to lender and to borrower. It is one thing to have interest rates low as the result of the pressure of savings or investment funds on the market. It is a quite different thing to depress the interest rate structure abnormally through excess reserves created by causes extraneous to our economy. I have always contended, and I reiterate now, that these abnormal pressures should be removed, and they must be removed as an essential element of defending the economy against possible inflationary over-expansion later on.

~~The goal of all policy is economic stability, not in the sense of a static condition, but in the sense of stabilized full employment avoiding the extremes either of inflation or of deflation as the economy progresses. Interest rates are an inseparable and important factor in economic stabilization. They are an essential part of a capitalistic system which is based on the creditor-debtor relationship. Interest rates should be fair both to debtors and to creditors and should be adjusted to the needs of the economy in different phases of the business cycle. A firming of short-term rates and a~~

~~floor under longer-term rates is what is needed at present. This can be achieved only if excess reserves are placed under control.~~

As an additional measure I favor exempting deposits held with the Reserve Banks and vault cash held by banks from assessments for Federal deposit insurance. While I have never been against interbank deposits, I do not favor over-concentration of funds that serve no useful purpose at money market banks ^{but tend} ~~where they serve only~~ to depress short-term rates to such low levels that the very banks which concentrate their funds in the money centers find themselves in an adverse competitive position. Nor is it to the interest of the money market banks to accumulate excessive correspondent bank balances on which they can earn nothing, but on which they pay the assessment. Furthermore, if a bank's funds are locked up by the authorities to serve as reserves, it is not fair to the bank to require it to pay assessments on the locked up funds that earn nothing for the bank. Another reason for exempting reserves ~~from FDIC assessments~~ is that there is no risk involved in depositing these funds with Reserve Banks and thus ~~there is~~ no justification for assessing a premium to insure them.

Some of the large city banks have been much interested in getting legislation that will exempt them from paying deposit insurance assessments on the interbank deposits they hold. It seems to me that since they pay no interest to the depositing banks on these funds, that the more equitable amendment would be to exempt the originating bank from paying the assessment if these funds are deposited with Reserve Banks. In other words, if any bank is to be benefitted

by exemption from the assessment, it should be the originating bank which deposits the funds as a reserve in the Reserve System, and not the bank that gets the use of the funds without paying anything for them. It is not in the interest of the city bank to have interbank deposits in abnormal amounts because they cannot be profitably used by reason of their volatile nature. The city banks should be interested in having only such correspondent bank balances as reflect the business done by the correspondent banks and the services rendered for them.

I have dwelt at some length on the general subject, with some of its ramifications, with regard to controlling monetary inflation by controlling excessive bank reserves. This subject, however, cannot be considered separately from the other sources of money-creation, that is, Government deficit-financing through the banks, and gold and silver policy. As an integral part of the general policy that is necessary for the period we are entering, we must discourage the purchase of Government securities by banks. For that creates new deposits. With the volume of bank deposits *and currency greatly in excess of* ~~already at~~ the highest levels we have ever had, it becomes important that we do not continue to add to this total, particularly at a time when one effect of the defense program is to activate the existing volume of deposits as they are drawn upon by business and put to more active use. Instead, Government securities should be sold to private and institutional investors. This has the effect of using existing funds rather than creating additional deposits. ~~Let me point out, incidentally,~~ ~~that~~ *W* when the Government borrows existing funds it does not reduce the supply because as soon as these funds are expended by the Government, they go right

back into the money system again, chiefly as bank deposits. Another popular mistake is to suppose that Government deficit-financing creates excess reserves. Instead, they originate from gold, silver, or other currency acquisitions. When the Government sells its securities to the banks, instead of creating excess reserves, this absorbs them because the new bank deposits thereby created have to be based upon or charged against the bank reserves.

So long as banks have an oversupply of excess reserves, they have every inducement to invest ~~them~~ in Government securities. That inducement can only be reduced or removed by reducing or removing the excess reserves which, as I have sought to indicate, should be adjusted to the normal requirements of business. If this is done the rate on Government bills and short-term notes would be likely to increase sufficiently ~~so that instead of being practically at no yield levels, they would begin~~ to attract the large amounts of idle corporate balances, representing reserves of various kinds, that have accumulated, ~~and will increasingly accumulate as business and profits expand.~~ For the most part, these funds are now deposited in banks and earn nothing for the corporate owners. They would be inclined to invest them in short-term Governments if the yield were raised from the prevailing artificially low levels. ~~It should be remembered that in pursuing an easy money policy as a recovery policy, the British did not permit their bill rate to fall below one-half of one per cent. It would be especially desirable at this juncture, when we should not increase deposits by selling additional Government securities to the banks, to attract idle existing funds into the short-term issues through a firming of the rate to a more natural level.~~ At the same time, longer-term issues should

be adapted to the requirements of insurance companies, savings banks, and individual or institutional investors. Thus the non-banking market for Government securities would be broadened out to absorb whatever Government financing may be necessary during the period in which we are making large defense outlays.

But deposits as well as reserves are also increased as gold and silver continue to flow into our money system. Even if we had authority to offset the effect of the gold and silver acquisitions on excess reserves, these acquisitions would still continue to add to deposits, unless we are prepared to deal with these factors at their source. I have publicly stated my opposition to the

purchase of foreign silver as unjustified ~~either~~ from a monetary standpoint, ~~or~~

for other reasons at this time it is considered desirable as of benefit, in the end, to domestic silver producers. In my opinion, Congress should repeal the present legislation, and at the same time cancel out the billion and a half of seigniorage which could be used for issuance of additional silver certificates. Likewise, I favor canceling the authority under the so-called Thomas amendment to issue \$3 billions of greenbacks. Both of these sources of funds, if resorted to, would add ~~both~~ to excess reserves and deposits, and would the expenditure of the \$2 billions now set aside in the stabilization fund. If these sums were added to the money supply, it would greatly accentuate the problem of the monetary authorities.

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The problem of gold presents a particularly difficult question. I

believe that Congress, in considering all the interrelated elements of the

monetary picture, should consider whether ^{or not} it would ~~not~~ be wise to make credits

available at low rates, as a means of aiding the British, taking as collateral

their gold, as well as their security holdings here, in Canada, or elsewhere, rather than to continue to accumulate more and more of the world's gold supply at the cost of inflating our banking and credit structure. ~~It is, as I have said, a difficult problem and one fraught with much controversy. Yet, it is one that we should face and analyze against the larger background of our national interests.~~

I have come last to the problem of the budget -- but not because it is of least importance. As long as we continue to operate on a deficit basis, it will be necessary for the Government to go to the market for the funds to make up the difference between tax collections and expenditures. ~~I have indicated the reasons why I think that at this stage the Treasury should do such borrowing as is necessary from individual and corporate investors, rather than from the banks.~~ However, I believe that we should at ^{this} ~~the same~~ time take further steps to close the gap between income and outgo as far as can be done ~~practically~~ without either confiscatory taxation or ~~discouragement of~~ ^{the retarding of} private enterprise. So long as the Government is rapidly increasing its total expenditures, I do not see how these outlays can be covered on a pay-as-you-go basis because the increased national income and the tax revenues resulting therefrom cannot be realized until some time after the sums are spent. In other words, there is a lag between the time when the Government has to raise the money and the time when it takes effect as income among the people who ultimately receive it in payment for goods and services. Taxes on 1940 incomes are paid in the fiscal years 1941 and 1942. There may be a lag of a year or a year and a half before money borrowed for defense, in effect, shows up in expenditures, then in higher national income, and finally in increased tax receipts.

It would not be wise to try to put sufficiently high rates into effect to close the gap entirely until we have reached a condition of full production and employment. But at that time, the tax system in effect should be adequate to bring about the balancing of the Federal budget.

~~In the interim I think we should close the gap as far as can be done without repressive taxation either on normal civilian consumption or upon capital formation required to finance new investment. We must not delay the revision of our tax structure until a full-employment income is reached. We should begin to reform the tax system at once. First and foremost, we should revise our corporate, individual and inheritance tax structure so as to close very important existing loopholes that make tax rates much less effective than they should be. For instance, there is not much use in raising individual surtax rates if corporations are permitted to hold back earnings in the form of idle funds instead of paying them out as dividends to stockholders. If the estate and the individual surtaxes are to be made as productive as they should be, then the gift tax must also be revised. The excess profits tax, which is clearly inadequate, should be revised to apply to all earnings above a certain ceiling, say, 10 per cent of invested capital, with such exceptions as may be necessary as a matter of equity. The present law allows an option under which corporations are able to make abnormal earnings after all taxes, including the excess profits tax, are paid -- earnings in some cases larger than they have ever been before.~~

the ~~revision of our tax structure~~ *should not be delayed until* *a full-employment income is reached.* We should begin to *re-design* ~~reform~~ *the tax system* ~~at once.~~ *in the near future.* First and foremost, we should revise our corporate, individual and inheritance tax structure so as to close very important existing loopholes that make tax rates much less effective than they should be. For instance, there is not much use in raising individual surtax rates if corporations are permitted to hold back earnings in the form of idle funds instead of paying them out as dividends to stockholders. If the estate and the individual surtaxes are to be made as productive as they should be, then the gift tax must also be revised. The excess profits tax, which is clearly inadequate, should be revised to apply to all earnings above a certain ceiling, say, of 10 per cent of invested capital, with such exceptions as may be necessary as a matter of equity *or to stimulate new business.* The present law allows an option under which corporations are able to make abnormal earnings after all taxes, including the excess profits tax, are paid -- earnings in some cases *larger* than they have ever been before.

I am heartily in accord with the proposals of the Treasury
The present tax structure, strengthened in the ways I have indicated, will bring in enormous revenues once the national income has risen to \$90-100 billions. As national income approaches these levels, rates should be raised still more if necessary to balance the budget.

with reference to the excess profits tax and to eliminate tax free securities.

In addition to our own large defense expenditures, the amount of which we cannot foresee at this time, there is the increasing amount of help to Great Britain which must also be taken into account. If the total of these reach a much larger figure than is now apparent, it may be necessary to impose selective consumption taxes on those things that are most essential to defense ^{civilian consumption,} in order to ^{production and} divert income to defense purposes. This may become necessary as a measure against a general price inflation. But such taxes should not be imposed until we have first placed on the statute books a tax structure sufficiently progressive to insure that the defense program will not increase the current inequality of wealth and income. Indeed, tax policy should be designed to minimize this ^{a wider distribution of the benefits as well as the burdens,} inequality. Increased consumption taxes are the most effective means when full employment and production have been reached, of preventing a general price inflation, but they presuppose the prior enactment of steeply progressive income and estate taxes.

Direct responsibility for taxation is, of course, outside the realm of monetary policy, but the subject of taxation cannot be separated from the primary concern of those charged with monetary powers and responsibilities. It is not possible to appraise monetary policy realistically without taking account of the effect of taxation and of Government financing on the banking and credit structure. ~~It follows that~~ When the time arrives when monetary restraints may become necessary, deficit-financing should be discontinued, thereby bringing the budget into balance. The time for such action will arrive when the economy has reached full production, that is, substantially full employment, and both monetary and fiscal policy may need to be invoked to maintain a proper relationship between production of goods and creation and use of money.

~~It is generally admitted that~~ ^{since} it would be practically impossible to

balance the budget while public expenditures are rapidly increasing and before a

much larger national income has been achieved, ~~We might, therefore,~~ consider viewing certain expenditures for defense as a capital investment. In effect, it may be considered a necessary substitute for an equal amount of capital expenditure by private industry which in borrowing for capital outlay would amortize the debt over the life of the investment. If we were to treat the investment in ships, bases, arsenals, factories, powder plants and the other capital investments paid for by the Government as private business would treat similar capital investment, we might then consider covering only the amortization, operating and maintenance costs out of current receipts.

No matter how these outlays may be regarded for bookkeeping purposes, the defense program is demonstrating before our very eyes the feasibility of raising the national income through governmental expenditures. Nor can there be any doubt that once a full income is achieved we can, out of a full income, raise enough taxes to cover expenditures. We can then have a balanced budget, ~~if we wish.~~

A full defense effort will bring very large profits. Profits of manufacturing and of trade were already very favorable in the five-year average 1936-1940. Indeed, for a great many companies they were larger than in any previous five-year period in their history. Many of our industries have learned how to live very well even under quasi-depressed conditions. At a national income level of from \$90 to \$100 billions, profits can be expected to rise to unprecedented levels. Without a steeply progressive tax structure these profits would bring increased concentration of wealth. Business leadership cannot afford to let the defense program yield this result. We shall do well therefore,

after the tax collection lag of the first years of defense expansion is overcome, to raise the whole of the budget through taxes.

There is one more suggestion in this field.
~~To this statement I feel compelled to make one qualification.~~ Some considerable borrowing, in lieu of taxes, from the mass of the population, in the form of a modified "baby" bond, ^{would be} ~~is not only permissible but~~ highly desirable, especially after a full employment income has been reached. If savings bonds are held widely through the country, by the whole population, a degree of security is achieved against unforeseen contingencies. In so far as such bonds may, after the defense effort is over, be converted into cash and the proceeds spent, business activity would thereby be stimulated just at the time when it needs to be sustained. Such a program would provide in some measure a post-defense cushion against depression. It therefore would seem to me wise, as employment increases and the income of the mass of the population rises, to ^{intensely the} ~~embark upon~~ a national campaign to sell as many savings bonds as possible, especially to the middle income classes. Such borrowing would not preclude us from balancing the budget because we could use the proceeds from the sale of savings bonds ~~[and from the removal of social security taxes]~~ to retire a part of the Federal debt now outstanding in the hands of banks and corporations.

Our productive ^{capacity} ~~potential~~ is greater today than ever before. It exceeds by far the peak reached in the boom of the Twenties. If we have the will to do it, we have the organization, man power, and resources to provide both adequate defense and a higher standard of living than any hitherto reached in our history. We are witnessing in the defense program what can be achieved in national prosperity, income and employment through adequate governmental expenditures. It is my hope that the country will never forget this lesson; that we shall

henceforth use fearlessly the resources of the state to help maintain employment and business activity at a full income level. Once such a program is boldly adopted as a permanent policy, businessmen can plan their operations on the expectation of a gradually rising national income. This they have never been able to do in the past. Such a policy, boldly conceived and persistently carried out, would revitalize private enterprise. There is nothing in this program that calls for Government operation of productive processes. All production, even on Government projects, can and should be carried out under private contract. Private business would be assured a full market. The necessary tax bill would be a small price to pay for an assured market adequate to absorb all the productive capacity of modern industry. Think what such a market would mean to business!

After the capital investment in defense is made, we will still have the heavy cost of maintaining our armed forces, which should be met out of current receipts. In addition, it is reasonable to expect ^{at that time} ~~that when the capital investment in defense is largely completed~~ there will be large accumulated deficiencies in private construction of all kinds and other capital requirements. But it is unlikely that the volume of private activity would be enough to make up for the deficiency in production and employment once the heavy defense outlays, including the large exports of military supplies to Great Britain, are over. At that time, it is of crucial importance that we be prepared to make the transition to a peace-time basis without precipitating a period of idle men, idle factories, declining national income and increased Federal deficits.

It would be tragically ironic if we, as a nation, solved the problem of unemployment by making instruments of destruction, but were unable to maintain

employment by making the things of peace. It is not for the purpose of returning men to the breadlines that we are making this vast defense effort to preserve our political and economic system. The transition will be effected more readily if at that point the budget is in balance. On the same principle that I stated at the outset, we should then be prepared to have Government take up the slack of employment, employing surplus labor, beyond what private activity absorbs, in useful ways. There are many with which you are familiar, such as public health and hospitalization, and particularly the urgent need for a vast reconstruction and improvement of our entire highway system to keep pace with automotive progress.

There is no excuse for defeatism, for having a static economy frozen at a level of under-employment. We are moving towards relatively full utilization of our men and our machines because of defense needs. When peace is restored to this world, we can, if we have the will and the wisdom, divert such of our productive facilities as are now employed in the destructive work of war into constructive work of peace. Thereby we can lay the foundations for a new and better world -- a world in which democratic institutions can survive.