CREDIT AND CURRENCY MANAGEMENT AND PRICE LEVEL

Address of

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Time on this crowded program will not permit me to discuss this question adequately. Your patience, which is remarkable, would be tried beyond endurance if I attempted to do so. I recognize that I shall have to strip my talk down to a few bare essentials, and sincerely beg your forgiveness for keeping you at all.

First, I hope to make it perfectly clear that we do not have a central monetary authority, or even a central banking authority, in the United States. In this connection, we ought to consider in the light of experience at home and abroad what a central monetary authority can do, and what it cannot do, to influence and control price levels through monetary action.

Secondly, I want briefly and frankly to discuss currency devaluation - changing the gold value of the dollar - as a lever to control prices. The most I can hope to do is to emphasize the importance of thinking that question through for yourselves to a definite conclusion.

Finally, I want you to consider with me whether the goal of our national endeavor should be merely to establish and maintain a certain price level, or whether we should not fix our sights on something of perhaps even greater importance - our national income, our employment, and our standard of living.

The Board of Governors of the Federal Reserve System is not the powerful monetary authority many of you believe it to be. I want to help you to look facts in the face even though some cherished illusions may fall and halos vanish in the process.

In the field of money and credit the spending policies of the government, its taxation policies, its deficit financing all are powerful factors, and they are in the hands of Congress, not of the Federal Reserve nor could they be delegated to any other monetary authority Congress might set up.

The gold stabilization fund and international exchange transactions constitute a powerful monetary force, and they are operated by the Treasury, not by the Federal Reserve. It is left with the Treasury to determine the nature of our gold operations. Gold inflow from abroad has taken place in recent years in quantities that stagger the imagination. During the past four months alone this country's net receipts of gold have amounted to $1,250,000,000. They are handled in such a way that their dollar equivalent is added to the excess reserves of the banks. And while the Federal Reserve is involved in the operation it has no more control over the policy than does the Board of Directors of your own American Farm Bureau.

In the banking field, federal responsibility is split up into several segments, of which the Federal Reserve has only one. It plays, in fact, a relatively minor role in banking supervision, even though its powers to influence general credit conditions are considerable.

Let me show you what I mean by a split-up in Federal responsibility. On a recent date there were 15,964 banks in the banking structure. Of these, only 6,341 are members of the Federal Reserve System. Of the members, 5,239 are national banks which are primarily responsible to the Comptroller of the Currency who examines and supervises them. The rest of the members are 1,102 state banks who choose to belong, and the Federal Reserve System shares the responsibility of examining and supervising them with the banking authorities of 48 states. Of the nonmember state banks, numbering 8,280, 7,356 are insured in the Federal Deposit Insurance Corporation, which shares the responsibility of supervision with the 48 state authorities. The remaining 924 are not insured. A comparison of the number of member banks with the number of nonmember banks, however, is misleading, since member banks represent about 85 percent of the country's banking resources.

Perhaps much that is worth-while might be accomplished by governmental authorities through supervision and through direct influence on the banks. In other countries this method is often quite effective.

I mention these things so that you may see the picture as it is, not as many people think it is. Now that I have at least tried to clear away some of the underbrush, I am willing to come to grips with the first question. If Congress creates a central authority with full monetary powers, can that authority, by action in the field of money and credit alone, establish and maintain a certain desired price level, say the price level of 1926?

I doubt it. In the first place, Congress could not even if it would delegate to the authority any control over taxation and spending, two powerful monetary factors. That, however, is aside from the main question. I would say that such an authority, using the powers

Congress might grant it, could insure an abundant supply of money and credit at low rates of interest. The existence of that supply of cheap money, however, would not guarantee the desired degree of economic activity, or the desired response in prices.

Money, in the modern sense, includes the currency and coin we use, and our bank deposits. These constitute our means of payment. Currency is available in whatever quantities the public demands. If circumstances created the demand, currency would flow out tomorrow in almost unlimited quantities. To illustrate that point, currency in the amount of $9,206,000,000 was issued by the Federal Reserve System in the 12-month period from July 1, 1937 to June 30, 1938.

It is a mistake to assume that the mere issue of currency has any monetary effect on the economic structure. The point is not whether the Government pays by currency or otherwise, but merely how much the Government spends and how it raises it. If it comes out of taxes, it may or may not diminish some other spending. If it comes out of savings, it may and may not diminish other investments. If it is borrowed from the banks, then it adds to the money supply as well as to the spending stream. If new currency is issued it flows right back into the banks, and only that quantity remains in circulation that the needs of business or the whim of hoarders calls for. As the currency is deposited with the banks it merely adds to the excess reserves of the banks, which are already very large.

Many of you believe, with Senator Thomas, that a monetary authority, by monetary action alone, could restore the 1926 price level and maintain it. Let's take a look at the record. What was the price and monetary picture in 1926 compared with today?

In 1926, the index of all farm prices was 145; that is, the average prices of farm products was 145 percent of the 1910-14 level. The index of prices farmers paid was 155. Farmers, therefore, were getting 94 percent of parity price in 1926. Grain farmers were getting 85 percent of parity.

In November 1938, last month, the index of all farm prices was 94. The index of grain prices was 60. The index of prices farmers paid was 121. Farmers were receiving 78 percent of the parity price. Grain farmers were receiving 50 percent of the parity price.

Now let's turn the page over and look at the monetary picture in 1926 compared with that of last month.

The daily average of money in circulation in 1926 was $4,645,000,000. The daily average in November 1938, was $6,750,000,000, an increase of $2,105,000,000, or 45½ percent, over 1926. Of course, the quantity of currency in circulation has nothing to do with prosperity or prices. If it did, March 1933 should have been a period of prosperity and high prices, for then the quantity of currency in circulation reached an all-time high. That didn't mean people were prosperous; it meant they were afraid of the banks.

The total of all bank deposits exclusive of interbank deposits and U. S. Government deposits, which was $46,440,000,000 in 1926, climbed to $51,250,000,000 in 1938, an increase of nearly 5 billions.

The monetary gold stock in 1926 was $4,165,000,000. In

November 1938, it was $14,162,000,000. The increase was nearly 250 percent.

How about the cost of money? The Federal Reserve discount rate in 1926 was 4 percent. In 1938 it is 1 percent in the New York bank; 1½ percent in the other Federal Reserve banks.

Compare the interest rates charged customers. In November 1926, the average rate charged in New York City was 4.79 percent. In November 1938, it was 2.38 percent.

The average rate charged by banks in 8 other northern and eastern cities was 5.06 percent in November 1926, and 3.28 percent in November 1938.

In 27 southern and western cities the banks charged 5.61 percent in November 1926, and 4.05 percent in November 1938.

Now just one more figure in this monetary comparison, and then I want to pass along to something else. You all have heard about excess reserves. They are the reserves which member banks have on deposit with the Federal Reserve banks in excess of the reserves they are required by law to hold. These excess reserves may serve as the basis for a multiple expansion of credit. In 1926 there were, practically speaking, no excess reserves at all. At the first of this month they stood at over $3,350,000,000.

We stand today approximately at an all-time high in the combined total of money supply and an all-time low in the cost of money. Yet we are about to finish a year in which the total annual income will reach approximately $64 billions compared with $73 billions in 1926 and about $79 billions in 1929.

In other words, we have fashioned for ourselves the longest piece of string we ever had. The trouble is, that while you can cut a string to about any length you want, you can't push it where you want it to go. Someone at the other end has to pull. We have the deposits - but they refuse to work. The annual rate of deposit turnover which was estimated at 20 times in 1926, and at 26 times in 1929, is running at a rate of about 13 times this year. People just aren't using the money they have as actively as they did in those earlier years.

I really hesitate to turn now to the second topic I outlined for discussion, because complete consideration of that issue would require more time than we could possibly command today.

Many of you believe that we can establish any desired level of commodity prices by changing the dollar value of gold. I devoutly wish the solution of the farm problem were as simple as that, but a fairly close study of the question has made a skeptic out of me.

There is no supreme court of finance and economics before whom this issue can be debated, and by whom it can be decided. Personally, I think the group in this room is just as competent to reach a sound conclusion as any in the world, provided they will question all assumptions and take account of experience in making up their minds.

For the belief that the level of prices can be raised or lowered at will by changing the currency price of gold <u>does</u> rest on an <u>assumption</u>, and it is very important to understand that. It is the crux of the entire matter. The assumption is that commodity prices are in reality gold prices, not currency prices; that fundamentally you sell your grain and your livestock and your dairy products for ounces of gold - not for dollars; and that you get the same number of ounces whether the price of gold is high or low. If that assumption is correct, then it follows as a matter of course that if you double the number of dollars a unit of gold represents, you double the number of dollars required to purchase the commodity.

If the controlling and primary price of a suit of clothes is an ounce of gold, then Congress, by raising the legal price of gold from $20.67 to $35 an ounce, could raise the price of the suit from, say, $21 to $35.

If the dominant price of 1000 brick is 232 grains of gold, and gold is priced at $20.67 an ounce, the brick might be said to be worth $10. If the assumption is correct, and if the gold price of brick is the real price, then when Congress and the President said that an ounce of gold would represent $35, not $20.67, the brick should sell at $16.93 per 1000 instead of $10.

But if after the price of gold is changed a similar suit continues to sell for $21, and the brick continues to sell for $10, you might begin to wonder whether after all the basic assumption is correct. Perhaps the dominant price was not the gold price, but the price in which business is done, that is, the currency price.

I recommend that this group study that basic assumption with the greatest care. I suspect you will find some interesting things about price behavior, leading into fields of international exchange, trade balances, and others that I simply cannot cover today.

There is another aspect which I feel I must touch upon, and that is this matter of average price levels. Averages are terribly misleading. Experts may tell you that the average depth of the Mississippi River is only two and a half feet, but you know there are a lot of places in it to drown you if you start to wade it.

Take some comparisons in farm price movements, for example. For the month of February 1934, after devaluation and the increasing dollar price of gold during the summer and fall, grains in the United States sold for an average of 79 percent of their 1910-1914 price. In November of 1933, grains averaged only 60 percent of the 1910-1914 price. Meat animals on the other hand commanded a price in February 1934, only 65 percent of their 1910-14 average, and by November of this year those prices had risen to 111 percent of the 1910-14 average.

These figures I have been giving are just samples, and they are not intended to prove anything beyond pointing up the question I have raised about the assumption on which devaluation to achieve a given price level must rest. The thought I want to leave with you is that we must study this and related proposals with an open and critical mind.

Of course, changes in the exchange relationship between currencies of different countries are important, and do affect prices of commodities in international trade. But that is something entirely distinct from the devaluation theory which I have been considering.

As my concluding point, I want to raise in your minds the question whether we aren't getting sidetracked when we concentrate our attention on a certain average price level and forget other goals that are perhaps of greater importance to ourselves and to the nation.

What we need in this country is an annual income comparable to our man-power, and our physical and monetary resources. We do not have it today. The great central question, the challenge to the nation, is this: How may our people be employed in the increasing production of useful things that will afford a higher standard of living to those who work?

I believe, and my associates on the Board of Governors of the Federal Reserve System believe, that the income and purchasing power of a prosperous agriculture are essential to that goal. Within the scope of their powers they will do their utmost to help you achieve it.

But aside from everything that can be done directly to make agriculture a driving power and not a brake in our economic machine, one important principle must be made to work if we are to hit the stride we are capable of. If industry and labor will look to full production for increased earnings, then we can produce and enjoy a constantly expanding national income. Incidentally, that is what agriculture always has done, and if the rest of the economy will learn to practice it, the treatment necessary for agriculture will be greatly simplified.

The job ahead of us is to bring about such a rate of production that all of our effective man-power may find useful employment. We are not going to do it unless and until the employers of labor look to increased production rather than to higher prices for profit; and unless and until organized labor learns that increased production is the only safe path to higher real wages.

Time and again we have seen it happen that manufacturers and other non-agricultural producers shove prices up at the first quickening of demand.

We have seen organized labor imitate them by striving for the highest attainable hourly wage for a minimum of production.

We have seen these practices kill off the goose which, alive, would have laid golden eggs. We saw them choke off the expected and all-important rise in building in 1936 and 1937.

What incentive, what economic mainspring, is necessary to keep industry running at capacity on things people need and want? And what will turn labor's eyes away from the hourly wage to a higher annual income earned through steady employment and the production of more wealth to share?

I don't pretend to be able to give you the answers. I do say that every policy of government, and of business, and of labor, ought to be tested by its contribution to that principle.

We have the men, we have the resources, we have the money and we have the human needs unfilled to justify a rate of production and a total national income far beyond anything we ever have dreamed of. If we don't learn how to achieve this under our own power, then we are going to be trying to do it in other, and strange, and less pleasant ways.

There is no magic way to achieve these desired ends, neither through monetary action, nor legislative device, nor by negative inaction. Adjustments will be called for that may be unwelcome and uncomfortable.

All elements - the manufacturer, the laborer, the farmer, the distributor, the carrier, the press, the educator - had better address themselves to this central problem. I hope our approach to it will be reasonably good-humored, tolerant of the other fellow's problems, and courageous - qualities which I like to think of as characteristic of the American way.

One thing we can all be perfectly sure of: sooner or later the American people are going to lose patience with an economy that tolerates unemployment and poverty in the midst of potential abundance.