

ABOUT BANKS AND WAR

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## ABOUT BANKS AND WAR

This Forty-ninth Annual Convention of the Kentucky Bankers' Association is held under conditions that leave a speaker no choice at all as to his subject. He may put some other name at the top but before he gets through he will be talking about banks and the war.

The whole American being down to its minutest detail is going to be distorted by world-wide convulsions. We had better realize that. If we are able to see these distortions for what they are, we can at least try to estimate what their effects will be. With that to start from we can form opinions as to what our behavior should be if we hope to lessen the extent of the ruin which wars inevitably spread.

Some day these wars that cover most of the world and threaten to engulf the rest may come to an end. That day will bring new and grave problems of readjustment. No economic problem stands isolated from those which preceded it and those that will follow. Each development is a link in a chain which reaches far back to men's beginning and stretches endlessly into the future. How the economy of the United States adjusts itself to conditions that will come when peace releases industry from its gigantic war effort, depends on the pattern of its behavior now and in the immediate future.

Bankers have more at stake in that pattern than most men. At present the trend is toward inflation. I shall point out some of the signs in a moment. Right now I want to turn aside to consider what violent ups and downs in business activity, either regional or nation-wide, have done to the banking business in the past. The record is appalling. From 1921 to 1929, bank suspensions tied up \$1,565,000,000 of depositors' money, and from 1929, through the bank holiday, tied up an additional \$3,600,000,000, while altogether more than 11,000 banks went to the wall. Vast

swings over which individual bankers had little or no control created this havoc. Banks went under which had administered their affairs wisely according to all existing standards, whose responsible leaders thought, at least, they had been making good loans and avoiding bad ones.

When these swings are under way the individual banker is about as helpless to influence or direct them as a toad under the farmer's harrow. Fair-minded men will agree that, while many bank failures were caused by poor management, the banker is not responsible in every case for the failure of his bank. Let me quote from an economist who works for the Federal Reserve System:

"In an economy like ours, where nine-tenths of the money is in the form of bank deposits, \*\*\* a drop in the national income to less than one-half of its normal level must inevitably result in the destruction of a considerable part of the value of bank assets. And since the bank's liabilities are not thereby reduced, the total value of the assets would no longer equal the total of their deposit liabilities. With full recognition of the fact that a part of our banking trouble arose from mismanagement and speculation, it is nevertheless certain that the major part of the catastrophe, particularly after 1929, was not due to mismanagement alone and in many banks was not due to mismanagement at all, but represented the effect on the banks of a collapse in the value of national wealth and income.

"Management, no matter how prudent, could not save a bank in a community whose income had been destroyed. And that is particularly true of a bank which has served the needs of its community adequately when the skies were clear. The answer is, therefore, that some of the banks that have survived are not banks at all, but pawn shops or open market investment houses. But there are others which have served their communities conscientiously and generously and have been managed wisely, and have survived. We congratulate them, but it is probable that their survival has been due in part to the element of luck. \*\*\* There never has been a battle in which all the participants were killed, and those who have survived have not always nor necessarily been the bravest or the strongest. They may not only be the ones who ran away but they may also be the ones whom the enemy fire happened to miss."

We all know what happened after 1929. It was not due either to the wickedness or greed or blindness of the bankers as a class, but they, like all the rest of us, were overtaken by supposedly natural forces which indiscriminately destroyed the prudent along with the imprudent, the good along with the bad. Of course, the banker always was and, probably always will be an ideal scapegoat. He is supposed to know something about money, and in about every depression that I ever heard of the first mass conviction that rises out of the disaster is that it is the money mechanism that has gone wrong.

Business is expanding now. Bank deposits are swelling, and loans are growing. Bank loans went up three billion dollars in the last year. Let us throw a quick flashlight over the economic scene and see why these things are happening. If one took the time it would be possible to trace the chain of events that brought this about, clear back to the dawn of history. For our purpose it is enough to recall the morning of May 10, 1940, when Nazi bombs started raining down on the Low Countries. At that time the total amount of money authorized for new armament in the United States was only about two and a half billion dollars. The National Defense Commission, the first of the long train of new agencies to direct the course of war preparation, was called together on May 30. Since then the citizens of this country have been trying to catch up with and actually comprehend a dizzily rising goal in arms production. Counting in the second Lend-Lease bill now pending, and including England's total orders actually placed here, that two and a half billion of 17 months ago has grown to 66 billions.

Only 13 billions of that sum have actually been spent, and yet the effect of it is visible in every state and country and town. The present rate of

spending is about 1.4 billions a month, and it is rising rapidly and will continue to grow for a long time.

Last month as the European war entered its third year the level of industrial activity in the United States was 60 per cent over that of 1939 when the war began. National income was at an annual rate of about 90 billion dollars, an increase of 25 per cent in the last two years. Purchases by consumers, shown by volume of retail trade, have reached an all-time peak. Commodity prices have risen sharply since February - the general wholesale index by 14 per cent, farm products by 30 per cent. Cash farm income for 1941 will be about 10.7 billion dollars, compared with 9.1 billions in 1940. The Department of Agriculture forecasts a farm cash income for 1942 of 13 billion dollars. Factory wage rates and number of employed have been pushing upward.

There are other important and inflationary signs on the horizon. Bank deposits plus money in circulation have risen to nearly 75 billion dollars, almost 20 billions above the total for 1929. Money in circulation has passed 10 billions, double the 1929 mark.

We can agree, I think that here are signs of a condition out of which devastating inflation can grow. We can also agree that the government is not going to abate the armament program just because of this prospect of inflation. But the warning from all past inflationary booms is written on the wall for all of us to see.

This threat can be averted. Ruinous runaway inflation, as well as its offspring, ruinous, precipitate deflation can be headed off if we, the people of the United States, will adopt a coordinated and courageous course. It will

require disciplined, intelligent action by national, state and local governments, by business and finance, and by labor and agriculture. The role of the individual, be he of high or low station, is important. But it can be done.

Just because I have stressed the effect on banks of violent swings of the business cycle doesn't mean I think that bankers are the only ones hurt. Workers and farmers, but particularly the fixed income and "white collared" classes all take a beating from runaway price inflation and its inevitable aftermath.

It would require every session of this convention to examine all parts of a complete program to offset the inflationary forces that are gathering. I can only mention some of them in the hope that they will indicate the path we should take.

From the National government:

Deep-cutting and courageous taxation that will finance as much of the arms program as possible by recapturing for the government most of the addition to national income which defense expenditures stimulate;

A financing program that will borrow as much of the additional sums required as possible from business savings and individuals, rather than from banks;

An end to all new public works not essential to defense, and a sharp curb on non-defense expenditures,

Direct price controls particularly of materials as to which war demand forces use of priorities or allocations,

Controls adequate to prevent wage spirals particularly in industries directly affected by war orders;

Action through appropriate agencies to prevent unwholesome credit expansion before it develops and adds to inflationary dangers, and

Every possible effort to spread war work so as to minimize boom conditions in some areas at the expense of labor and employment in others.

State and local governments should cut their expenditures in every way possible. I do not believe, however, that this means they should reduce their rates of taxation as long as they are in debt. The excess of revenue should go to paying off debt. That course would be anti-inflationary.

I suggest that the rule for business concerns and individuals is pretty much the same - to avoid expansion of debt and to pay off debt wherever possible, and to invest savings in Defense Savings Bonds or other appropriate government issues.

One short quotation from Marriner Eccles states this idea better than I can. He says:

"When incomes are at high levels, that is the time when people should reduce their debts or get out of debt. Our people cannot spend their increased incomes and go into debt for more and more things today without precipitating a price inflation that would recoil ruinously upon all of us... By deferring civilian demand at this time, we can help avoid inflation, we can aid in defense, and we can store up a backlog of buying power that will help offset a post-defense slump."

All these call for self-discipline -- lots of it. It is human to hope

that the sacrifices that are made will be at the expense of the other fellow. But it cannot work that way. Up to now we have talked long and loud about sacrifices but none of us, except the boys who left school or job to go into training have actually made any. Before this crisis has passed each one of us will have to give up something he would rather keep. No one can escape or should expect to. Wars work that way.

In the fields of credit controls, I know that some of you, at least, must have tangled with Regulation W which has established standards of down payment and length of terms for instalment credit in certain fields. You may have thought of that regulation, which went into effect on the first of September, as the beginning of your difficulties with credit control. I have no desire to see it judged too lightly, or for other than what it is - an attempt to set the brakes on the expansion of instalment credit as part of a general movement to combat inflation.

The volume of consumers' instalment debt has been ballooning right on top of swiftly rising incomes. For the first time in history it has passed the six billion dollar total. The new regulation of instalment credit is a part, and relatively not the most important part, of a broader program aimed to prevent these forces I have been talking about from driving prices out of reach. A further specific purpose is to slow down demand for articles which compete directly with defense for materials, labor and factory capacity.

Some people fear that regulation of instalment terms may take away the poor man's chance to buy the good things of life. It is not instalment terms but defense needs that will determine how many automobiles, refrigerators, and

other specified articles are actually going to be produced for civilian use. Fewer people, whether rich or poor, will be able to get new cars, for example, regardless of whether instalment terms are regulated or not. What the low-income worker really needs to fear - and what instalment regulation helps to protect him from - is sky-rocketing prices which dip into his pocketbook and cut his real wages.

Probably many of you are perplexed over some angles in the application of that regulation. I will not touch on any of its detail today. In general, I hope you will keep in mind that the problem is new for the Reserve Board in Washington, and for us who must administer it in the field, just as it is new to you. We have to grow along with the subject just as you and your customers must do.

There is another angle to instalment credit regulation which must have occurred to men of responsibility who try to think beyond the present.

Business will not have any difficulty in selling all of the goods that it will be permitted to produce in the years immediately ahead. In the post-war period, however, it will be easier to make sales if consumers have not built up a heavy burden of debt that must be paid off before they can buy additional goods - debts that stretch on years after the fat paychecks of the defense boom have come to an end. It will be better to have savings than debts when this defense production tapers off.

Now in conclusion, let us try for a moment to lay aside the vocational lenses through which each of us looks at the world, and to think out loud just as citizens of the United States. This nation has been forced by external

developments beyond its control, once again to take sides in a world-wide war. I cannot answer the question as to how far our participation will go any better than you can. Forces wholly outside the United States may make or modify the answers anyone can give today.

A new rule in international affairs is being demonstrated over three-quarters of the earth. It is the rule of military power in which nothing else counts. The demonstration hasn't ended yet. It is still spreading. There is no limit to its growth except restraint imposed by fear of greater power.

Wealth and resources and population alone do not constitute power in the sense I am talking about. Unless they are organized into effective military power, they are more likely to serve instead as bait tempting to aggression. A nation may possess mountains of gold, millions of acres of factories and millions of manpower; it may lead the world in its productive genius, and still be weak and flabby by the standards of the rule now current over the most of the world. These resources can be organized into power; until then they are negligible factors in the equation except as they constitute an open invitation to some modern Attila to come and get it.

War today is incredible in its speed, range, destructivity, malignancy and totality. It is important to dwell on that last word. We in the United States haven't yet grasped its meaning. Total war as the dictators practice it subordinates every interest and consideration to the one end of complete victory over present and potential enemies of their regime. That is the compact and deadly purpose against which we aligned ourselves when we assumed the role of arsenal for the forces that resist the Axis. Yet even now, 17 months after

we started to mobilize our resources for defense, sacrifices are still in the conversational state. As individuals and as groups we want our privileges and immunities untouched. We have accepted a grim challenge but as a nation we haven't yet geared to meet it. There can be no excuse if we, the greatest industrial power on earth, fail in this.

The years ahead of us will test our individual and national fiber as it has never been tried before. It is a mistake to over-simplify the job. Helping to defeat one dictator, or set of dictators, won't end it. We left unfinished, perhaps even uncharted, the job of domestic recovery and rehabilitation to undertake vast responsibilities in a world-wide war. It would be supreme folly to engage in that war only once again to turn our backs on the peace. If the sacrifices we make are to mean anything they must have a purpose; and that purpose, to have meaning, must seek to avert from the next generation the horror that threatens to engulf this one.

These are real issues; more real, perhaps, than some of immediate concern which I have attempted to discuss today. The outlook is dark if we cannot hope to meet them better in the future than we have met them in the past. This is a time for understanding, not discouragement; for cooperation, not disunity, and for the kind of optimistic courage Kentucky has always shown -- the courage which is a heritage handed down by pioneer ancestors to the citizens of this state.