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Political File

PUBLIC SPENDING AS A MEANS TO RECOVERY

A Statement of Chairman Eccles' Position

The business situation in 1932-33.

The salient feature of the business situation in 1932 and early 1933 was the existence of unutilized capacity in practically every line of business. This was a reflection of the decline in the national income of over 50 percent, -- from \$81 billion in 1929 to \$39.5 billion in 1932. Although, with the increase in population, the real need for goods was greater than ever, the income out of which goods could be bought had shrunk and this gave rise to excess and unused productive capacity. The amount of unutilized capacity was incomparably greater and more widespread than anything that had ever existed previously. In 1921 the national income showed a decline of only 14 percent from 1920. In 1924 and 1927 it actually increased over the previous years. The maximum shrinkage in the national income in England in the recent depression was only 10 percent.

The rapidly declining demand for all goods was reflected in falling prices and increasing losses for business. In 1932 incorporated businesses alone showed a loss of \$6.5 billion. Confidence in the outlook for profits had been completely dispelled by the cumulative effects of three years of deepening depression. There was a general desire for liquidity and increasing repugnance to indebtedness of any kind. On top of this came the banking collapse. Such a development would be deflationary at any time. Coming when it did, however, its deflationary effects can hardly be over-emphasized. Checking accounts

in banks, which had already declined by nearly \$7 billion to June 1932, showed a further decline of \$1 billion by June 1933. In addition, over \$3 billion of time deposits were in banks remaining closed after the banking holiday. It cannot be doubted that part of the explanation for the slowness of the recovery movement can be attributed to the desire of individuals and businesses to replenish balances wiped out from 1929 to March 1933.

With the decline in the national income, the revenue of municipalities, states and the Federal Government likewise declined. Although tax rates were raised and new taxes were imposed, the deficits of public bodies were increasing. This led in turn to curtailment of expenditures on the part of public bodies other than the Federal Government.

The prospects of a "natural" recovery.

In these circumstances the prospects for a natural recovery did not appear encouraging. Recovery entails an increase in the demand for consumers' goods. Such an increase in demand must in general be dependent upon an increase in incomes rather than the spending of previously accumulated balances. According to recent investigations in the Board's Division of Research, consumers' checking accounts formed a very small proportion of the total in 1933. It is known that consumers' savings had been seriously depleted in the depression, that over one-sixth of the population was being supported by public bodies, and that a proportion of the remainder

was being supported by relatives. Moreover, the widespread insecurity and uncertainty would have militated against the drawing down of balances of those consumers who possessed them. It appears, therefore, that an increase in the demand for goods was dependent upon an increase in consumers' incomes.

Incomes, broadly speaking, can be increased in two ways -- by the disbursements of business and by the disbursements of public bodies. The prospects of a natural recovery, therefore, depended upon increased disbursements by business. It was not enough for business to make the goods demanded by consumers. If incomes were to be increased, business had to make disbursements for increased inventories or increased capital equipment.

Various factors militated against such an increase in expenditures for inventory and fixed plant. The chief one has already been stressed -- the existence of unutilized capacity. It must appear uneconomic to any business executive to add to his productive facilities when he is already using only a part of his existing facilities. American industry was geared to supply a demand for goods exceeding that experienced in 1929. A very large increase in demand over that prevailing in 1932 had to be anticipated, therefore, before increased facilities would be necessary. Even if there were confidence that in three or five years such facilities could be

profitably used, the prudent course would have appeared to be to delay their purchase in order both to avoid the risk of obsolescence and of an incorrect forecast.

The factor of unutilized capacity appears to furnish the decisive answer to the argument that if the budget had been balanced the resulting restoration of confidence would in itself have led to recovery. There is nothing in balancing the budget that would lead to an absorption of excess capacity and hence make it profitable for business to increase its disbursements for plant and equipment. On the contrary, balancing the budget, by curtailing the incomes of people receiving money from the Government and by reducing buying power through increased taxes, would have been expected to decrease demand and hence increase excess capacity. The effects would have been analogous to a decrease in wage disbursements by industry accompanied by higher prices for products.

There are various other considerations which in the recent depression militated against an increase in disbursements. It is estimated that states, cities and counties spent over two and a half billion dollars annually on construction in the period 1925-30, and that their expenditures for this purpose in 1933 amounted only to approximately \$800,000,000. An explanation of this decline is to be found in the reduced incomes and property values in municipalities, and the existence of legal debt limitations. The electric power industry alone spent nearly one billion dollars on construction in

1929 and in 1930. Despite the fact that there was less unutilized capacity in this industry than in almost any other, its expenditure for construction in 1933 was only \$130 million. This low level of expenditure may be in part attributed to special legislation affecting utilities. Railroads, which spent over a billion dollars annually up to 1929 on plant and equipment, reduced their expenditures drastically. It is generally recognized that they could not and would not spend more on equipment until their traffic and revenues expanded, but expansion of revenues depended upon expansion of business.

Another large outlet for investment is in residential construction. In the years 1925-28 expenditures in this field amounted to over three billion dollars annually. In 1933 they amounted to some \$250 million. The explanation of the virtual cessation of building appears to be twofold. In the first place, the shrinkage in individual incomes decreased people's ability to build. Secondly, the shrinkage in incomes resulted in a drastic fall in rents, while building costs did not fall correspondingly. Hence, by and large, it was cheaper to buy or rent than to build. A fall in costs was dependent upon (a) lower rates of wages in the building trades, (b) lower transportation charges, (c) lower material costs, and (d) lower interest rates. By 1933 little progress had been made in lowering these various elements of cost and the prospects, apart from lower interest rates, were not encouraging. Moreover, a very large number of foreclosed properties overhung the

market. Higher rents would follow increased incomes; but increased incomes, leaving Government expenditures out of consideration, are mainly dependent upon increased construction and equipment expenditures.

The magnitude of the deflationary forces that continue after the trough of a severe depression may easily be underestimated. In the first place, there is a widespread repugnance, amounting almost to dread, of indebtedness. A substantial portion of any increased revenues may be used for the reduction of such indebtedness, or held in the form of cash to meet maturities in the future. Corporations which adopted the policy in the depression of converting part of their equipment into cash by postponing repairs and replacements will be slow to depart from this policy. Individuals who have witnessed or experienced economic insecurity may be eager to devote any increases in incomes to insurance and saving. In addition, a portion of any increased income will be devoted to the repayment of debt incurred in the course of the depression, to payment of arrears of rents and taxes, and to reduction of loans on insurance policies.

Two elements necessary for recovery appear to have been the satisfaction of the widespread desire for liquidity and the increased availability of capital at low rates of interest. In the depression psychology prevailing in 1932 rates of interest were low only on comparatively riskless investments. For most business men and home owners, where the safety of principal was at stake, the rates were

very high. A period of increasing earnings would have changed this picture but increasing earnings were dependent in turn upon increased disbursements, incomes and the demand for goods.

An expansion of demand deposits would have satisfied the demand for liquidity, caused investors to seek employment for idle funds and facilitated the transition to lower interest rates. In this case, again, however, an expansion of deposits could have come about, in the absence of Government borrowing, only as a consequence of increased business borrowing and security flotations.

The point is occasionally made that since the durable goods of both consumers and producers were not being fully maintained and were wearing out from 1929 to 1932, a time would be reached when they would have to be replaced and that this factor would bring about a natural recovery. Insofar as consumer durable goods are concerned, this belief rests on the assumption that consumers deliberately delayed purchases of automobiles, houses, etc., that they could have afforded to make and accumulated balances instead. In view of the drastic shrinkage of individual incomes and the increase in unemployment, it would seem much more reasonable to assume that consumers cut down their purchases of durable goods from necessity rather than by choice, and that renewed purchases of such goods waited upon an increase in incomes.

Similarly, the decrease in the production of durable producers' goods was partly a reflection of decreased ability to buy, as, for example, was the case with railroads, and partly a reflection of the absence of need for such goods to meet current demands. It is pertinent in this connection to point out that expenditures just sufficient to maintain the plant necessary to satisfy the demand for goods prevailing in 1932 would not have been sufficient to increase incomes. It would appear, therefore, that "deferred" demands would have remained deferred until a rise in incomes and in the demand for goods would make it possible and profitable to satisfy them.

It is conceivable that if unit costs can be reduced sufficiently profitable operations may become possible and this in turn may lead to plant expenditures. Australia succeeded in bringing about a modest general reduction in costs both of capital and labor in 1931. In this country, however, by 1932 prices and output had declined so drastically and losses were so large that the prospects of bringing about a sufficient reduction in costs while maintaining current demands appeared hopeless. A mere enumeration of some of the inflexible costs that would have had to be drastically reduced indicates the magnitude of the task. Such costs include real property taxes, freight rates, power rates, trade union wage rates, and, for concerns in a weak financial position, interest charges. Technological improvements that permit reduction in unit costs proceed but slowly, considering the country as a whole. Moreover,

output would have had to expand simultaneously with a reduction of unit costs, as otherwise the total disbursements of industry and hence the national income would have declined still further, calling in turn for further reductions in costs.

Finally, there remains to consider the possibility of a recovery arising from the departure from the gold standard and the fall in exchange. It cannot be doubted that such a step was a necessary condition for recovery in this country, but it hardly appears sufficient in itself to initiate a recovery. In a country whose exports are large relatively to its home production the stimulus of increasing exports may be sufficient to lead to an upward trend in business. In this country, however, a considerable expansion of exports would constitute a very small increase in total production. Moreover, as recovery proceeded it would be difficult to maintain an undervalued exchange rate and to prevent imports increasing as rapidly as exports. Our own experience was that imports increased more rapidly than exports.

To this point various possibilities by means of which a "natural" recovery could have occurred have been examined. Although definite proof is never obtainable in questions of this kind, a weighing of the probabilities leads to the conclusion that none of them would have been sufficient to bring about recovery. This conclusion rests on the widespread unutilized capacity in 1932-33, on the existence

of depression psychology, and the persistence of deflationary trends, on the difficulty of reducing costs sufficiently to wipe out the enormous losses then prevailing, and on the improbability of a sufficient increase in the world demand for American products to turn the tide of business here.

The alternative of Government intervention

Since the prospects of a natural recovery appeared so dubious, the only alternative was one initiated by the Government through an increased spending and deficit-financing program. In this way, it was expected, incomes would be increased, the demand for goods would be increased, excess capacity would be absorbed, and it would become profitable for business to add to its facilities and for individuals to build new houses. As the national income increased, tax yields would rise and the need for emergency expenditures would decline. In the latter stages of the recovery movement, when it was proceeding under its own momentum, the emergency debt built up in the depression could be retired.

The magnitude of the spending program

It is apparent that not all Government expenditures lead to an increase in buying. Refinancing expenditures, for instance, serve a highly useful service in preventing forced liquidation. They do not, however, result in a positive increase in the expenditures of the public. Similarly, when the Government spends money that is collected in taxes and would have otherwise been spent by the taxpayer,

there is a transfer of buying power rather than a net increase. Although the net activity-stimulating expenditures of the Government cannot be exactly measured an attempt was made to approximate it by deducting from total expenditures all those expenditures which are of a refinancing or "capital-bolstering" nature, and all taxes except estate taxes which are assumed to decrease in some measure the expenditures of the public. The results are presented in Table I.

Table I

Net income-increasing expenditures of the Federal Government
for the years 1933-1936 (In millions of dollars)

1932	1,851	1934	3,304	1936 (1st ✓
1933	1,914	1935	✓	six months)

It will be observed that the net contribution of the Government to the buying power of the community was little greater in 1935 than in 1932, indicating the slowness with which the spending program got under way. The contribution in the first six months of 1936, exclusive of the bonus, was \$ ✓ than in the previous year.

The actual receipts, total expenditures, recovery and relief expenditures, and the deficit for the fiscal years 1934-36, are presented in Table II.

Receipts, Expenditures and Deficits of the Federal Govt., Fiscal Years 1934-36.

	<u>Receipts</u>	<u>Total</u> <u>expenditures 1/</u> (In millions of dollars)	<u>and relief</u> <u>expenditures</u>	<u>Deficit 1/</u>
1934	3,116	6,745	4,004	3,630
1935	3,800	6,802	3,657	3,002
1936	4,116	6,804	3,291	2,688

1/ Exclusive of debt retirements and bonus payments.

It will be observed that receipts have increased steadily, while total expenditures exclusive of debt retirements and bonus payments have remained constant. Recovery and relief expenditures have declined, but this has been offset by an increase in other continuing and regular expenses of the Government, such as expenditures for national defense. The actual deficit has declined steadily. The explanation of the downward trend in the deficit as contrasted with the steadiness of the net activity-stimulating expenditures in Table I is mainly to be found in the heavy repayments of loans by banks to the Reconstruction Finance Corporation, which while decreasing the actual deficit are not considered to decrease current spending.

The reason for excluding the bonus payment is that it represented an obligation of the Government incurred in 1924, which would have had to be paid in 1945. Moreover, it was not a part of the recovery and relief program, although undoubtedly a substantial portion of the payment resulted in a net addition to the current expenditures of the public.

In order to obtain some idea of the relative magnitudes of the Government's contribution to income, it may be of interest to present some relative comparisons:

Net activity-stimulating expenditures of the Federal Government, 1934-35, as a percentage of		Percent
(a)	The sum of the national income for the years 1934-35	68
(b)	The sum of the increases in the national income for the years 1934-35 over 1933	36
(c)	The total volume of all construction for the years 1927-28 (Kuznet's Estimates)	24
(d)	Building contracts awarded for the years 1934-35 (F. W. Dodge Corporation Reports)	191

The spending program and the volume of deposit currency

The volume of checking accounts in all banks, plus the demand deposits of the Government in commercial banks, expanded between \$8 and \$9 billion between June 1933 and June 1936. Part of this increase was attributable to an increase in the banks' holdings of Government-guaranteed bonds, part to the deposit of incoming gold, and the major part to the increase in banks' holdings of the public debt. The increase in the member bank holdings of \$4.8 billion amounts to 43 percent of the increase in the gross public debt in this period.

This increase in checking accounts means that individuals and corporations are holding some \$8 billion more cash than in 1933, -- in fact are holding somewhat more than in 1929. This unquestionably has resulted in a great improvement in the liquidity of business and has been perhaps the major factor in forcing long-term interest rates down to their present level. So far, therefore, from Government borrowing absorbing the available savings of the community and thus operating to drive interest rates up, it has in effect added greatly to the supply of loanable funds. This has, of course, been due in turn to the existence of excess reserves which made it possible for banks to subscribe to Government bonds without curtailing their other earning assets.

The spending program and the recovery movement

How far can the recovery to date be attributed to the spending program? It is obviously impossible to give a mathematically exact

answer to this question. In this, as in other problems of economics, we can only attempt to weigh the probabilities in the light of our understanding of the economic mechanism and of our insight into the question of business motivation.

We may approach the problem by listing various factors on which there would appear to be little room for difference of opinion:

1. The borrowing of newly-created money or of money that would otherwise be idle does not decrease the current expenditures of the community so far as that money is concerned, though it may possibly decrease the spending of other money.

2. Passing this money over to people on direct relief and work relief, to wage earners, and low-salaried workers, probably results in an immediate increase in purchases of various kinds by almost a corresponding amount.

3. When business makes additional goods to satisfy this increased demand, more income is disbursed to low income groups, This in turn gives rise to additional purchases.

4. If this gives rise to profitable operations on the part of business, if it is not regarded as a temporary spurt, and if costs can be reduced by new equipment, capital expenditures will take place. This gives rise to additional income.

5. If rents rise to a point where it is more economical to build a house than rent, new houses will be built. This gives rise to additional income.

These various statements are not proved, but a strong presumption of their validity is established, if it can be shown that actual developments can be explained in their terms. Insofar as it can be shown that actual developments cannot be explained in other terms, the presumption that the major part of the recovery movement is attributable to the spending program is greatly strengthened.

Turning to actual developments, it does not appear reasonable to attribute the boomlet of 1933 to the spending program, since the program did not really get under way until October of that year. The most plausible interpretation of the 1933 rise appears to be that it was due almost entirely to inventory purchases engendered by the expectation of rising prices that were expected to follow the departure from gold, the adoption of the NRA, and the public works program. The short-lived character of the rise indicates that expenditures should be continuing and steady in character if the groundwork is to be laid for an orderly recovery movement.

Starting with the movement that began in the closing months of 1933, recovery has become increasingly more orderly and steady. This period also marked the beginning of the positive spending program. The national income produced in 1934 increased \$6.7 billion over 1933. Preliminary estimates, which very possibly are too low, indicate a further increase of \$4.6 billion in 1935. Allowing for secondary spending on the one hand and for the continuance of restrictive developments (for example, continued liquidation) on the other, there is nothing incompatible in interpreting the sum of the increases in

the national income in 1934-35 over 1933 of \$18 billion in terms of the net direct and primary contribution of the Government of \$6.5 billion in the same period.

The expansion in the demand for goods and in the production of goods up to the close of 1935 was mainly in consumers' goods. This is in accord with theoretical expectations. Only a small portion of Government expenditures was on heavy construction projects and the bulk of the recovery and relief expenditures went directly to people in the low income classes. The existence of widespread excess capacity made it possible for industry to meet the increased demands for consumer goods without adding to its plant facilities. In the latter part of 1935 and thus far in 1936 industry here and there is finding it profitable to make expenditures for new equipment and plant.

According to various indexes, rents have been rising and vacancies have been declining. This development has been accompanied by steadily increasing residential construction. In this field, therefore, the sequence of events is in accordance with theoretical expectations.

The growth in deposits has already been mentioned. This is clearly attributable in major part to deficit financing. The substantial fall in interest rates in the face of heavy Government borrowings is likewise in accordance with expectations, since the resultant increase in funds available for investment had until quite recently met with no demand from industry.

Summarizing the discussion to this point, various considerations were advanced to the effect that the probabilities were strongly against a natural recovery getting under way in 1933. The recovery that actually occurred is explainable in terms of the spending program and the sequence of events has been in accordance with theoretical expectations. It is now proposed to consider whether the recovery can be attributed to any other factor.

It is well-known that business disbursements to wage earners have increased in the past three years. The important question, however, is whether these increased disbursements were a reflection of an increase in demand generated from other sources, or whether business disbursements initiated the increase in incomes and the demand for goods. Information is available which throws some light on this question.

Recent investigations have indicated that business deposits experienced a very large increase from 1933 to the close of 1935. How can such an increase be accounted for? It is known that instead of borrowing, business was reducing its indebtedness in this period so that the increase did not arise from this source. A sample study of corporations indicated that only a small portion of the increase could be accounted for by the sale of marketable securities held in corporation treasuries. The repatriation of American business capital held abroad could likewise account only for a small portion of the increase. Finally, business probably advanced more credit to consumers

than it collected in debts from consumers. We are left, therefore, with the remaining possibility. Business must have received more from the community in the sale of goods than it paid out in wages, dividends and other payments to the factors of production.

This means, in other words, that while business increased its disbursements in answer to an increase in demand it did not initiate the increase in incomes and demands by paying out more than it received from the sale of products. If business had paid out more than it received in the sale of goods it would have expended money on additions to plant and equipment, making up the difference by drawing down its balances, by borrowing, or by new stock issues. It appears, therefore, that the impetus and motivating force behind the recovery to date is to be found in the other important source of new income, the net activity-stimulating expenditures of the Government.

Present phase of the recovery movement

In the past six months there have been encouraging signs that the recovery movement is beginning to progress to a point where it can proceed under its own momentum. The machine tool industry has been active. Additions have been made to plant, particularly in the steel industry. Building construction is increasing. Railroad equipment buying is growing and promises to increase still further, and there are indications that the utility industry may soon be forced to add to its facilities.

The magnitude of such expenditures, however, is as yet comparatively small, both in relation to such expenditures in the Twenties and in relation to the current volume of saving. While the need for the Government's net contribution to the increase in the national income is diminishing, there is no assurance that it can be dispensed with entirely at this time. It would, in other words, entail grave risks of imperilling the progress of the recovery movement either to cut expenditures abruptly or to impose heavy taxes of a kind that decrease the buying power of the low income groups.

If the promise of a substantial increase in equipment buying and building construction is borne out it should be safe to decrease the Government's contribution substantially in 1937. This would permit an approach to a balanced budget. The actual deficit, exclusive of the bonus and debt retirements, in the fiscal year 1936 was \$2.7 billion. With the yield from the new tax on undistributed earnings and the increased yields from income taxes arising from the rapid growth of individual and corporate incomes this year, there appear to be reasonable grounds for believing that the deficit in the fiscal year 1937 will be substantially less than in the fiscal year 1936, and that it will be still further reduced in the calendar year 1937.

Problems raised by the spending program

(a) The burden of the debt. This question may be considered both in accounting terms and in economic terms. In accounting terms the burden of a debt cannot be determined unless the debt is related to national wealth and the interest charges related to national income.

The total gross debt, after giving effect to the bonus payment, amounted to slightly less than \$34 billion on June 30 of this year. As an offset to this debt the Government had a proprietary interest in loaning agencies of \$2.5 billion, a cash balance of \$4.2 billion, and a Stabilization Fund of \$2 billion. Since the ultimate disposition of the Stabilization Fund is a little uncertain it is the more conservative course not to deduct it from the gross debt in arriving at a net figure. The net debt, therefore, was approximately \$27 billion on June 30.

Although accurate figures of the national wealth are not available, it appears evident that the net debt is a small percentage of the net wealth of the country. The value of listed stocks alone, which must represent only a small portion of the national wealth, amounted to \$51 billion on July 1, 1936.

The interest charges on the Government debt amounted to \$750 million in the fiscal year 1936. This was only $1\frac{1}{4}$ percent of the estimated current depressed national income of \$60 billion. In the fiscal year 1932 the interest charges amounted to $1\frac{1}{2}$ percent of the national income. Despite the increase in the debt, therefore, the burden of the debt actually declined from 1932. This has been due to falling interest rates and rising incomes. While a further reduction of the average yield on Government securities cannot be counted on, there is fairly good assurance

of a steadily increasing national income. Since, therefore, further additions to the debt should be of modest proportions, there is a reasonable assurance that the burden of the debt will decline steadily with the progress of recovery.

The increase in the net debt attributable to the recovery and relief spending program from June 30, 1933, to June 30, 1936, is less than \$7 billion. The increase in interest charges attributable to the spending program is correspondingly small. It does not appear, therefore, that in accounting terms the burden of the debt has been increased as a consequence of the spending program.

In economic terms a debt incurred at home simply means that the nation is borrowing from itself. When a debt is retired the nation is paying itself. The only way in which the creation of a domestic debt can worsen a country's economic position is when the proceeds of the debt are used to divert people from the making of consumers' and producers' goods to the production of uneconomic things. In the present case, as was argued above, the expenditure of the proceeds of borrowings resulted in the employment of people who would otherwise have been idle and in the production of goods that would not otherwise have been produced. From this point of view, therefore, the spending program has not only been costless to the community but has actually improved its economic condition.

(b) The danger to banks

It has been generally recognized that the purchase of Government securities has enabled the banks to convert losses into profits. Alarm is sometimes expressed, however, that this development, while temporarily favorable, may result in heavy losses to banks at some future date if and when interest rates rise substantially. Although this cannot be ruled out as a possibility the dangers may easily be exaggerated.

It may, in the first place, be pointed out that the possibilities of loss are small in the case of obligations maturing within five years. Of the total direct Government obligations held by member banks of \$10,564,000,000 on March 4, 1936, \$6,771,000,000 matured within five years. Should the market value of the remaining \$3,794,000,000 fall by as much as ten percent, this would amount only to \$379,400,000. This is only 7.3 percent of the capital funds of member banks.

There does not appear to be any good reason why member banks as a class should ever have to realize this paper loss if it occurred. Wholesale liquidation would be called for only in a severe contraction, such as occurred in 1931-32. It is to be expected, however, that with the FDIC and the recent changes brought about in the Federal Reserve Act, the occasion and necessity of a period of forced liquidation will be avoided.

Finally, it may be pointed out that many authorities feel that long-term interest rates are destined to remain at comparatively low levels for a long period. A considerable rise in short-term rates need not result in a corresponding rise in long-term rates. Even in 1929 the average yield on Government bonds was 3.65 percent.

It is interesting to observe that the British banks held almost as large a percentage of their assets in Government bonds as do the American member banks, the percentage for British banks being 40 percent on December 31, 1934, and for American banks, including holdings of Government-guaranteed securities, 41 percent on March 4, 1936.

(c) The danger of "inflation"

Many people, observing that inflation in various countries in the war and early post-war period coincided with unbalanced budgets, have expressed fears that an unbalanced budget here might likewise result in inflation. The term "inflation" is generally used to denote a sustained period when the demand for goods is outstripping the production of goods. It is characterized by rapidly rising prices, speculative inventory buying, shortage of labor, and increasing inefficiency. It is obviously a condition to be avoided at all hazards.

If the war and post-war cases of inflation are studied more closely it will be observed that they all share the same characteristic of heavy and increasing Government deficits resulting in a rapid increase in the supply of money, at a time when industry was

already operating at capacity and no more goods could be produced.

The lessons we may learn from these experiences are, first, that it is of paramount importance to achieve a balanced budget, including provision for debt retirement, as capacity production is approached and, secondly, if this is not possible, to prevent Government borrowing from resulting in an expansion of the deposit currency of the country at such times. An essential element of a Federal spending program is that it should be compensatory in both directions. We must be as prepared to adopt activity-depressing measures at certain times as we are to adopt activity-stimulating measures at others.

There does not appear to be any cause for alarm as yet. As pointed out above, the recovery and relief expenditures of the Government have been declining for the past three fiscal years and revenues have been increasing. The recovery movement is beginning to assume the appearance of a natural recovery. Unless Congress makes very large new appropriations and unless business recedes, a balanced budget is definitely in sight. Both parties are committed to this objective.

There is another way in which deficit financing in a depression may lead not to inflation but to an undesirable boom. If too great a volume of deposit currency is built up in the process, it may later prove to be excessive for conditions of healthy prosperity, even though the Federal budget may at that time be in balance.

This aspect of the problem is of particular concern to the Reserve Administration.

The volume of currency and checking accounts is at present approaching \$32 billion, which is over \$5 billion in excess of 1929. It is impossible to determine what the probable turnover of this money will be when recovery is fully achieved. It is worth noting, however, that from 1923 to 1929 the total supply of money passed on the average three times through the productive processes in a year, resulting in the creation of income equal to approximately three times the amount of money. Should, by any chance, this ratio be restored, the present supply of money would correspond with a national income of over \$90 billion. It may be hazarded that such an income would not be excessive in relation to our capacity to produce goods. It is obvious, however, that this is something that must be closely watched. A further large expansion of deposit currency would entail a definite risk of a recovery movement at some future time developing into a boom.

Conclusion

In seeking to appraise the spending program to date it is difficult to avoid the dangers of being either unduly critical or unduly enthusiastic. The fact that the appraisal here has run in favorable terms should not be interpreted as indicating that the view is held that the timing, magnitude and method could not have been enormously improved or that the experiment has

been brought to a successful conclusion. There are, however, two basic considerations which have made the appraisal more favorable than would otherwise be the case.

One is that an economic experiment almost by necessity has to be confused, imperfect, and made up of many diverse elements, some working at cross purposes. We must, in other words, have a different standard of judgment than would be proper in, say, a chemical experiment where the right things can be done at the right time, in the right magnitude, and definite proof is obtainable.

The second basic consideration is that, dangerous as an economic or social experiment may be, it may be even more dangerous not to make it. Dangerous as it was for the Government to embark upon a spending program financed by borrowing in the past three years, it may be held that it was even more dangerous not to have embarked on this course.

In view of these considerations the program has worked out surprisingly well to date. If it can be brought to a successful conclusion — and the prospect now appears reassuring, we will have acquired knowledge of a powerful weapon to combat the evils of economic instability in the future.

July 31, 1936.