COMMENTS ON THE RECOMMENDATIONS OF THE FEDERAL ADVISORY COUNCIL

The recommendations of the Federal Advisory Council are somewhat difficult to criticize because in the main they consist of categorical statements without any supplementary material or analysis of the economic consequences which the Council expects from their adoption. There are many subjects covered in the recommendations and it might be well to take up some of them for analysis.

1. The Council advocates a gold standard in the sense that the dollar has a fixed gold content and that at all times all currency of the United States shall be immediately redeemable in gold bullion at the rate so fixed. This is essentially the same type of gold standard that we have adherred to in the past with such disastrous results at certain times. The only discernable difference is that there is no coinage of gold or redemption of gold coin which in any event is of little practical significance. This type of a monetary standard is definitely a "fair weather" standard and one which entails serious consequences to our whole financial and economic system in case of economic difficulties.

Whenever there are banking troubles and runs are developing upon banks there is the tendency to have hoarding of gold by the domestic population. Furthermore, the system is always vulnerable to rapid drains of gold by foreigners repatriating funds from short-term balances or by sales of American securities. Also, Americans themselves may move capital funds out of the country with great rapidity leading to severe outflows of gold. These movements would not be disastrous if we had not built up a large volume of bank money upon a gold reserve with fixed legal reserve requirements, and therefore when reserves are depleted pressure is put on the whole banking system leading to a multiple contraction and destruction of bank money which is the most important type that we use today. Thus, when such a deflation takes place it has concomitant adverse effects upon the prices, production, business profits, and employment.

Also it should not be forgotten that the gold standard does not give us an automatic device which prevents the development of unsound deposit expansions because the same volume of gold under our elastic banking system may support widely different volumes of bank money and this money is subject to great changes in its velocity of circulation. As a matter of fact in order to make the gold standard work satisfactorily in the past, it has been necessary to introduce extensive control measures, and to expect it to work at all in the future these controls must be increased rather than diminished. The gold standard has never provided stability in purchasing power for the money of the country in terms of goods and services as the gold standard itself does not prevent wide variations in the general price level. It is this type of stability rather than a stability in the gold content of the dollar which is of more importance to the economic life of the country.

In this connection it is perhaps worth while to note that the Council explains that the views expressed now simply reiterate the position taken at the meeting of November 21, 1933. It is true that the Council did advocate the return to gold at that time but it neglects to state it also professed to favor a dollar of steady purchasing power. Apparently the Council does not realize that there may be conflict between these positions and that it might be impossible to have a dollar of steady purchasing power while at the same time maintaining a dollar of fixed gold content which is always redeemable in bullion.

The main reason for advocating a gold standard has been that it provides stability of exchange rates between foreign countries, and therefore facilitates trade and commerce between the nations of the world. This feature of the gold standard has been greatly overrated by economic observers in its importance in trade relations. For satisfactory foreign trade, meaning here the exchanges of goods and services, the assurance of the same exchange rate for many years in the future is not of tremendous importance. All that is essential is short-run stability so that a futures market in foreign exchange may be established. The only type of international transactions that would be facilitated by long-run fixed exchange rates are financial transactions. However, even here the importance of the gold standard has probably been exaggerated. One of the primary factors in making the gold standard unworkable has been the ease and rapidity with which capital funds move from one country to another with changing economic conditions. When we have such a large volume of our wealth represented by securities which can be sold readily and there is a free foreign exchange market, the gold standard itself provides no assurance at all that an individual will be able to change his assets from one currency to another because any country will be forced off of the gold standard if there develops a pronounced movement in one direction by the foreign or domestic holders of large amounts of investments. In the past the gold standard has not provided long-run stability in exchange rates as it has broken down often in case of wars or in times of severe economic difficulties. Also, it might be added that we perhaps have had too large commitments in foreign countries on capital account by holders who assume that they will be able to realize on them at almost a moments notice. If capital is to be invested abroad, the owners must realize that they have responsibilities to the country in which capital is invested as well as rights to income from such investments.

In summary, the gold standard has many weaknesses and it must be carefully managed if it is to provide a "standard" which is worthy of the name. In this management we must be prepared to prevent the whims of individuals in their decisions as to how and where their money will be held from having disastrous consequences upon the economic life of the country as a whole.

2. The Council expresses great concern about the unbalanced budget of

the United States. Obviously an unbalanced budget cannot be maintained indefinitely. However, the policy of the Federal Government demands large Federal expenditures as a part of its recovery program. If this program is successful and we enjoy a great increase in national income there will be no difficulty at all in balancing the budget and retiring the debt which has been incurred during the depression.

Although the Council does not explicitly advocate a balanced budget at the present time, the implication is that attempts should be immediately made to curtail Government expenditures and to decrease the Government deficit. This position can only be supported as a recovery measure on the basis that the certain reduction of monetary incomes from smaller Government expenses or from increased taxes will be more than set-off by the increase in incomes which will result from the increased spending by business men and individuals as a result of greater confidence engendered by the budget balancing policy. Upon the basis of existing evidence, this position is uncertain to say the least and, therefore, the Administration can hardly be condemned for refusing to take part in such a gamble.

3. Government competition with business has received much publicity by the critics of the Administration of late and is always a popular hue and cry. However, this competition has been of small consequence and there is no indication upon the part of the Government that it will increase to alarming proportions. As a matter of fact the financial operations of the Government in entering the fields which had been normally reserved for private capital were of great benefit to the country, and were welcomed by the financial and industrial organizations which were on the brink of disaster at the time and were saved only by Government action. Incidentally there were no great protests in those years of more pressing economic difficulty.

4. The Council expresses grave fears of inflation and forecasts the

disastrous consequences that inflation would have upon certain classes of our population with the usual hackneyed statements which appear in discussions of this type. It is amazing that banking leaders should give such prominence to these views after their experiences in going through several years of the most severe deflation that this country has ever experienced, which has destroyed property values, income from investments, business activity and employment, and lead to a decrease of 40 to 50 billions a year in national income. Undoubtedly, the classes which they refer to have suffered in this period to an extent comparable to what similar classes suffered in the so-called uncontrollable inflations which European countries experienced in post-war years.

As a matter of fact we should be worrying about counteracting the still serious consequences of the past deflation instead of worrying about an inflation which might develop in the future. This deflation the Council calmly dismisses by saying, "The past five years have seen an immense liquidation of speculative excesses which have occurred in finance and industry. The business organism is again in a position to function normally if it is given assurance of stability."

To accept as inevitable the development of uncontrollable inflation in the United States is a naive attitude. Inflation is one of the concepts we use without any real understanding of what the term means. In most simple terms inflation characterizes a period in which the money supplies are increasing faster than goods and services are being placed on the market. We are a long way from a situation of this type, and with our tremendous unutilized capacity and a large volume of unemployment it will be sometime before we could have a dangerous inflation. Only when we get relatively full employment and full utilization of our productive facilities do we need to worry about further expansion of the monetary supply. With an increase in production our budget deficit would disappear and there would be no need for Government expenditures to continue at their present high volume as the demand for labor by private business greatly increased. Thus, we would not have a continued need for large Government expenditures and deficit which was one of the unavoidable factors which furthered the inflations in post-war Europe. Also our economy is not one that depends to a considerable extent upon imports and exports and we are not faced with the necessity of making large outward payments currently.

We have methods of controlling an unsound expansion of money were it to develop, but there is no need to cross bridges until we come to them.

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