To: Mr. Thurston

September 1, 1937

From: V. Lewis Bassie

Subject: Mr. Flanders' Letter of August 24.

Mr. Flanders' letter of August 24 indicates that several misunderstandings have arisen in regard to some of the points raised by this Division in reviewing his manuscript. In Mr. Currie's absence I am taking the liberty of writing a few comments on these points.

1. By taking out of context Mr. Currie's statement that "the various factors operating to bring about a large increase in the monetary supply did not bring about a corresponding increase in total expenditures, that is, in general business activity", Mr. Flanders comes to the conclusion that this "means that we have learned that the increase of the money supply by government borrowing and spending does not result in a normal stimulation of business under the conditions of the last two or three years."

This conclusion is not warranted, however. The statement repeated above was not intended as the most significant statement in the memorandum but merely as a more or less obvious explanation of "obvious facts." Perhaps the word proportional should have been used instead of the word corresponding. In any case, the implication is merely that, when the money supply is increasing rapidly, some of the new funds may go into inactive deposits rather than into active circulation.

The conclusion reached by Mr. Flanders would be true only if there had been no increases in general business activity during this period. The Department of Commerce figures show that national income paid out rose to $62.1 billion in 1936 from a low of $44.9 billion in 1933, after falling from a high of $78.2 billion in 1929. As of June 30 of the corresponding years, the money supply of the United States was $29.8 billion, $19.9 billion, and $26.4 billion, respectively. Thus, while business activity increased more than money from 1933 to 1936, there was nevertheless a larger percentage increase in money, so that business did not increase proportionally, and velocity continued to fall off. The income velocity of money fell off from 2.96 in 1929 to 2.26 in 1933 to 2.08 in 1936. The identification of total expenditures with general business activity in Mr. Currie's statement clearly indicates that he was thinking in terms of the income velocity of money (as above) rather than the circular velocity (as discussed by Mr. Flanders at a later point in ~~Mr. Flanders~~ his manuscript).

2. The statement that Mr. Currie did not hold the volume of credit to be a primary criterion of policy did not mean that it could not be so held, if anybody wished to take that position. Mr. Currie would agree that the objective of monetary control is stable business conditions at a level of employment as high as can be continuously maintained. But he would insist that no simple formula could be a sufficient criterion for monetary policy designed to achieve that objective.

3. The point of the question, "Should the term 'inflation' be restricted to changes in the money factor alone?" was not that general expansion should be included under the definition of inflation, but that, in view of the discussion, changes arising on the side of velocity alone should perhaps be excluded. The importance of such changes in the past may be open to question, but that they exist as a possibility in the future was indicated in the first paragraph of Mr. Currie's memorandum.

4. Such remarks as "the self-destructiveness of booms should be clearly demonstrated" are not so much an argument against that position as a suggestion that the position ought to be established at some point in the manuscript. This is true especially if the term "boom" is differentiated from the term "prosperity". It is true that depressions follow periods of high activity, but the decline may be initiated by a variety of factors, and it should be argued that these are internal to the conditions existing during the "boom", if "self-destructive" is to be used validly in this connection.

5. No question was raised regarding the validity of the argument concerning the dangers of inflation that accompany a high level of relief expenditures. This point was clearly understood. The remarks noted were simply a suggestion that the discussion of relief expenditures as a weapon for dealing with depressions should be separated from the discussion of such expenditures as a road to inflation, in accordance with the scheme adopted in discussing other ~~methods~~ means of control.