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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 6, 1937.

To Mr. Thurston

From Lauchlin Currie
LMC

Subject: Fiscal Policy and the Business Cycle, by Ralph E. Flanders

This manuscript comprises Part II of a volume on the above subject and is arranged in chapters V to XI, as follows:

Chapter V, "The Problem of Financial Stability", is a general introduction to Part II and discusses its relationship to Part I, which is concerned with "the flexible budget", more commonly termed "compensatory fiscal policy". The importance of financial stability, as determining the rate of spending, is emphasized as a factor in the more fundamental movements of employment and production during the business cycle.

Chapter VI, "Money, Banks, and Bank Credit", outlines the mechanisms of "our credit money system." Common currency is distinguished from bank deposits as means of payment, and the origin, types, functions, and possible amounts of each is discussed from the standpoint of control directed at moderating their influence upon the movements of the business cycle.

Chapter VII, "The Business Cycle", discusses various theories of the business cycle and the possibilities of regulating the various factors with which those theories are concerned. On the monetary side, the following conclusions are reached: (1) Public expenditures should be regulated in inverse order of magnitude to private expenditures, in order to counteract the cyclical fluctuations of the latter. (2) Wise use of taxation, especially income taxation, should be made to alleviate inequalities of income that contribute to oversaving and overinvestment. (3) There should be a reordering of banking practice and banking mechanisms to prevent unwarranted price increases and forced credit contractions.

Chapter VIII, "Objectives and Criteria of Credit Control" indicates the necessity for keeping in view the ultimate objective of stable economic conditions rather than any immediate criteria of policy such as prices, foreign exchange rates, or interest rates. The most acceptable of such criteria is found to be a constant volume of money, but even this is qualified to the extent that changes in the velocity of circulation must be taken into account.

Chapter IX, "The Means of Control", uses the well-known monetary formula MV = PT as a basis for the discussion of control, pointing out that existing controls operate primarily on the first term. The Federal Reserve controls, rediscount rates, open market operations, etc., are found to be effective only in preventing expansions and to need supplementation during a depression. This is held to be the function of "the flexible budget" in increasing spending at that time.

Chapter X, "The Dangers of Inflation and Debt", carries further the discussion of the policies recommended, in terms of the above monetary formula, with special emphasis being placed on the necessity for decreasing public expenditures and retiring public debt in times of prosperity. The point is also made that this country is in a position to put such policies into effect because there is small danger of inflation under ordinary conditions and because our debt is far less burdensome at present than that of many European countries. There is also inserted in this chapter a recommendation that the Government participate in direct relief at times of unusually heavy unemployment by grants-in-aid to the various states.

Chapter XI, "Survey and Summary", points out the necessity for maintaining business confidence if total spending is to be kept at a high level by the use of these policies. The manuscript closes on a note of peroration, appealing to all concerned for cooperation in dealing with the problem of the business cycle.

This volume brings together a wide range of material stressing the effects on the cyclical movement of business of banking mechanisms, monetary policy, and fiscal operations. While the plan advocated is not new in essence, it is presented in simple and convincing fashion, so that there should be among the readers of the volume many converts to ideas that have already gained wide acceptance among persons specializing in this field. On the whole, it is a sound statement of the position and indicates that the author is already familiar with most of the general criticisms that might be offered against it.

There appears at times a tendency to take for granted rather than to argue certain points that might be denied by some writers. These have been noted and questioned wherever found. A number of minor errors, many merely grammatical in nature, have also been noted. Inasmuch as it hardly seems worthwhile to discuss these in detail in a separate memorandum, I would recommend returning the manuscript to Mr. Flanders, with the pencil notations in the margin to call his attention to these points, so that he could make such changes as appeared to him advisable.