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July 12, 1935

Honorable Duncan U. Fletcher
United States Senate
Washington, D. C.

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Dear Senator Fletcher:

I have the telegram which you referred to me on July 4, urging you to support the Goldsborough amendment to the Banking Bill. This amendment would direct the Federal Reserve System and the Secretary of the Treasury to restore and maintain the general level of commodity prices at the average for the years 1921 to 1929 and to this end would make it the duty of the Secretary of the Treasury to establish a free and open market for gold and silver.

The principal purpose of this proposal is to prevent wide fluctuations in prices, particularly of agricultural commodities, which in the past have caused great injustice and suffering to farmers.

No one questions the fact that all efforts should be directed towards keeping price fluctuations within reasonable limits. But it should be realized that changes in prices are only part of the picture. There have been periods since the war when commodity prices on the average were stable, while the volume of industrial production went up or down by as much as twenty percent. In fact, the entire orgy of speculation in 1928 and 1929 occurred with a relatively stable level of commodity prices.

Proposals for price stability as a guide to monetary policy necessarily refer to some index or average of prices, because stability of prices of individual commodities is neither feasible nor desirable. Those interested in price stability, however, are thinking for the most part in terms of the prices of their own products. For example, the cotton grower is interested primarily in the price of the cotton which he has to sell and the prices of the goods that he has to buy. A stable general level of prices would not satisfy him if it represented, for example,

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the net effect of a fall in the price of cotton, which is what he has to sell, offset by a rise in the price of food which he has to buy. Nevertheless, under the proposed mandate the Federal Reserve Board would have discharged its responsibility if it achieved this result.

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Or, as another example, should prices of domestic articles be depressed because prices of imported goods advance? This would mean that the American people would have to be content with less for what they sell, because they would have the privilege of paying more for what they buy; certainly a doubtful source of satisfaction.

A similar question arises when a technological improvement results in the lowering of prices of commodities, like automobiles or electric refrigerators, for example. Would it be desirable to offset this decline by raising other prices in order to maintain stability in the general price average? Would it not be better for the country as a whole to take advantage of lower prices to increase consumption, production, and employment, without disturbing other prices?

What producers are primarily concerned with is not the prices of their products alone, but the net return on the sale of their products, which is the result of the volume sold, times the price, less the volume of materials and other elements of cost, times their prices. In manufacturing industries, production is under control, but the volume of sales depends on the market; and when profits decline, manufacturers can reduce their losses by reducing the volume of their output. In agriculture, production is less easily influenced because it depends in larger part on natural forces, and changes in buying power of the public are reflected chiefly in fluctuations in the prices of agricultural products. Farmers, therefore, have a direct interest in sustained industrial employment and national income, which are essential for the marketing of crops at profitable prices.

In the final analysis, the object of enforcing price stability is the effect that it would have in moderating fluctuations in business and in assuring justice between creditors and debtors. Price stability, therefore, is not so much an end in itself as a means to an end. The maintenance of the national income and of full employment is more important to the national welfare than is the maintenance of a specified average of prices of a selected group of commodities in wholesale or retail markets. When unem-

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ployment prevails there is a lack of buying power and, in the absence of an adequate demand for goods, a decline in prices inevitably follows. Maintenance of employment in turn depends on the maintenance of a reasonably constant level of production.

In setting up a standard to guide the Federal Reserve System, therefore, it should be proposed not to confine the mandate to the maintenance of stable prices but to make it broad enough to cover all the more essential elements of economic life, namely, the restoration and maintenance of as full employment of labor and of the productive capacity of the nation as can be continuously sustained.

An integral part of the policy of price stability, as proposed in the Goldsborough amendment, is that the Secretary of the Treasury, with the advice of the Federal Reserve Board, shall manipulate the prices of gold and silver in a "free and open market." The adoption of such a provision might go a long way toward destroying the effectiveness of the proposed legislation. It would make it impossible for the Federal Reserve System to use effectively the powers that are within its jurisdiction, namely, open-market operations, discount rates, and reserve requirements, because the effects of its actions could at any time be nullified by operations of the Secretary of the Treasury in the open market for gold or silver. The Secretary's powers in this respect would be unlimited under the proposal, except that he would be required to obtain the advice of the Federal Reserve Board.

This country's policies in regard to gold and silver are among the most controversial public issues. Within the past two years Congress had adopted with regard to these metals definite policies, which include strict control over private holdings and private trade in either gold or silver, Congress also prescribed definite limits within which changes in the price of gold may be made and entrusted the execution of its policies, within these limits, to the President of the United States and the Secretary of the Treasury. It would surely not be wise at this time without careful consideration to sweep away all these considered policies, to remove all limitations on the prices of the metals, and to reopen the gold market to private hoarders and speculators.

The theory of the amendment is that a desired price level can be reached and maintained and that this can be accomplished by the use of the powers entrusted to the Secretary of the Treasury and the Federal Reserve System. Apart from the dontroversial ques-

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tion of the validity of this theory, the foregoing discussion has made it clear that price stability alone is not an adequate objective of monetary policy and that the broader objective looking toward the national welfare should be adopted.

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Very truly yours,

M. S. Eccles
Governor

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