

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

# Office Correspondence

Date January 18, 1939.

To Chairman Eccles

Subject: Material for use in reply

From Lauchlin Currie

to Byrd

*LMC*

Attached are some additional pages to accompany the material I sent you  
last night.

January 18, 1939

ADDITIONAL ERRORS AND FALLACIES  
IN SENATOR BYRD'S REPLY

1. The Rôle of Saving

Senator Byrd's contention that the case for compensatory spending rests upon a rejection of the "time-old virtues of thrift, frugality, self-reliance and industry" is completely without foundation. Compensatory spending provides an indispensable means of establishing the economic environment in which these character traits can flourish and find scope for fulfillment. The cost of the kind of fiscal policy which Senator Byrd advocates, in terms of its effects on the character and morale of the people, is difficult to overestimate.

During periods of low national income and widespread material distress, many people are forced to make up their deficiency of current income by encroaching upon the savings which had been slowly accumulated for a quite different purpose, such as to provide for old age or the education of children, or as a protection in the event of disabling illness or other personal misfortune. It is only during periods of prosperity that the habits of thrift and frugality can find full expression in generous accumulation of actual savings. It is a familiar platitude, but one which, nevertheless, is well worth repeating, that the volume of saving

is necessarily limited by the available investment outlets, and that when investment opportunities are restricted, the national income is held down to a point which effects a corresponding restriction of saving.

Private industry is little disposed to undertake investment expenditures for new plant and equipment when, owing to a contracted national income, the consumer demand for the products of industry is not sufficient to permit adequate use of existing productive facilities. This is the dilemma inherent in all depressions. In an earlier period, this dilemma has usually been surmounted sooner or later through the intervention of some outside factor. During the nineteenth century and the early decades of this century the fact that the United States was a young and relatively undeveloped country, possessing in the background strong forces of spontaneous growth, favored the emergence of these outside factors. In the recovery from the depression of 1920-21, the existence of an acute housing shortage provided the needed recovery stimulus, just as it has more recently in England. But under modern conditions it would be reckless in the extreme to adopt the passive and negative fiscal policy which Senator Byrd advocates in the hope that, through some unforeseeable accident, some outside factor might come along to rescue us from stagnation. It is a strange irony which permits Senator Byrd to regard his policy as one of cautious wisdom, and a compensatory policy as a reckless wasting of the nation's resources.

Government borrowing during periods of deficient national income has a dual effect in encouraging saving. In the first place, it makes more saving possible by directly providing an additional outlet for saving. Second, the growth in consumer purchasing power resulting from government expenditures financed by borrowing furnishes the basis for a fuller utilization of productive resources and an expansion of the capital expenditures of private industry. By enlarging private outlets for saving, such a policy makes possible a further growth in the savings of the community.

## 2. Equity Financing v. Debt Financing

The view that, in the field of corporate finance, the proportion of equity to debt financing might desirably be increased is undoubtedly well founded. Nevertheless, progress in this direction should be wisely planned, with adequate attention to the sources from which savings are drawn. Many of those who sponsor a larger proportion of equity financing think only of the convenience of the corporation wishing to obtain additional funds, ignoring the needs of the savers from whom the funds are presumably to be drawn.

The advantage of equity financing to the corporation obtaining new funds is clear. Instead of assuming burdensome fixed charges, it may--if the venture for which it seeks additional capital turns out badly--write the whole thing off without embarrassing formalities or difficulties. Equity investments of the venturesome character are entirely suitable for well-to-do individuals capable of assuming

risks and taking losses. It is highly important, however, that the equity financing device should not be used by corporations as a means of capitalizing on brief waves of excessive speculative enthusiasm and of diverting the savings of the less well-to-do from more secure investment channels. Small savers who are accumulating for their old age, for the education of children, or for protection in case of unforeseen reverses and misfortunes should not be asked to put their savings into securities which furnish a largely unpredictable future return. What this group of savers seeks is a type of investment which provides a stable and assured return. The record over the past ten years not only of equities but also of many bonds and mortgages formerly considered as of the highest grade points strongly to the necessity of an adequate volume of public securities to meet the needs of those savers who, in at least a part of their investments, require security above all else. Small individual savers, and such institutional savers as savings banks and life insurance companies, fall within the group of those who appropriately demand that a considerable part of their funds should be invested in obligations of highest security.

Quite apart from this important range of considerations, it would be fantastic to suggest that no new outlets for savings shall be made available to the community until such time as corporations are ready to float equity securities. Past experience conclusively demonstrates that equity financing assumes really large proportions

only after prosperity has reached an advanced stage. If an attempt were made to suppress alternative types of investment outlets, it is unmistakably clear that we should be committing ourselves to indefinitely sustained depression.

### 3. The 1933 Business Spurt

Senator Byrd says that from March to July 1933, when our fiscal actions were sound (according to his standards), the greatest increase in business occurred in the history of our nation. The index of basic industrial production to which he refers -- an index which, incidentally, is especially sensitive to volatile, speculative influences in business -- rose 67 per cent in the course of a few months.

Senator Byrd is not quite accurate in calling this the greatest increase in business on record. It was, indeed, the most violently rapid upward spurt. In attributing this upward spurt to our "sound" fiscal policies, the Senator shows a surprising ignorance of the forces then shaping our business developments. Has he forgotten entirely the effects of our departure from gold and of the passage of the N. R. A. including a \$3.3 billion appropriation for public works? Both these developments led to a sudden, speculative accumulation of business inventories to profit by the anticipated rise of prices and costs. In stressing economy in the ordinary budget while entirely overlooking the \$3.3 billion appropriation for public works, and in entirely overlooking the potent forces making for temporary accumulation of inventories, Senator Byrd has gone far indeed in searching for arguments and debating points to support his position.