

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

# Office Correspondence

Date January 21, 1939.

To Chairman Eccles

Subject: Reply to Senator Byrd

From Lauchlin Currie

*LAC*

Please keep in mind that this is a first draft. I am not at all satisfied with the opening and I have rewritten it. It is now being typed and I will send you down a copy later in the afternoon.

January 20, 1939.

*Not sent  
Held in Files*

CHAIRMAN ECCLES' REJOINDER TO SENATOR BYRD

Your reply to my letter was, I am afraid, calculated to becloud and confuse the basic issues at stake rather than to sharpen and focus attention upon them. Lest I fall into the same error, let me again state these issues.

The really basic issue at stake does not, as you state, "relate to taxes and debts". It relates to the problem of achieving and maintaining, in the America of today, and under our democratic and capitalist institutions, a condition of full employment and stable prosperity.

This problem cannot be solved by simple analogies to past periods in this country or other countries, unless it can be shown that in all essential details save one, the elements in the problem are exactly similar. This condition, of course, cannot be met. Hence, I suggest, statements from revered authorities of 100 years ago, however applicable they may have been for the conditions of a rapidly expanding frontier community, are no more applicable to the conditions of today than, doubtless, our statements will be to the conditions facing our descendants in the year 2039. It is worth remembering that the statesmen you quote met the problems of their day in terms of the facts of the then existing situation. We should follow their example.

The conditions facing America since 1931 are unique. They have no parallel in our past history. They will not be solved by appealing to authorities, past or present. They can be solved only by bringing

to bear upon our common problem our experience, our understanding of the functioning of our capitalistic system, our intellectual integrity, and our good will.

The problem, then, is achieving and maintaining full and steady employment. The main issue between us as to how this problem may be solved can be stated simply.

You believe that all the essential elements in our economy which put a bottom on depressions and brought about revival throughout the Nineteenth Century and up to 1929 are still potentially existent; that they have failed to operate only because of the lack of confidence "on the part of the business community in the fairness of Government", because of Government deficits and because enterprise is not free.

I, on the other hand, believe that we face a new world, with new conditions and hence new problems; that the vigor of the expansive forces of the Nineteenth Century and of the brief period of the Twenties, when we extended our frontiers to the world, definitely weakened after 1929. Our economy apparently suffered, at least for the time being, a severe impairment of its recuperative power. How temporary this impairment may be does not concern us here. We have our own problem to solve, not those of our descendents. Throughout 1930, despite a budgetary surplus, a gold standard and a Government heartily approved by business men, conditions on which you place your reliance for full recovery, the situation went from bad to worse. By 1932 and 1933 we had long passed the stage of a depression, as the word was understood up to that time. Never before had our collective incomes fallen so far; never before had we such an excess of productive capacity and man power in relation to effective demand.

In these circumstances I believe that the new conditions confronting us called for a new diagnosis and a new treatment. When private enterprise, because of a superabundance of existing idle facilities, will not borrow and spend more than it takes in, thus increasing money income and the markets for its products, the community must do this collectively, through its Government. Buying power must be built up to a point where the existing capacity is largely absorbed and the consequent spending on new capital goods offsets the money withdrawn from the income stream in the form of savings.

As a business man, I know that I won't expand my productive capacity when I can't use profitably the capacity I already have. As a banker, I know that unless somebody is prepared to borrow savings, the money ceases to circulate and becomes idle. As a student of the subject, I have come to appreciate that everybody's income is somebody else's spending, that income and spending are merely two aspects of the same operation. Acting individually, we spent our way out of past depressions; acting collectively, we are spending our way out of this one.

On this basic issue you have little to say. Your scattered remarks bearing on the point may be summarized as follows:

1. England recovered from the depression without Government borrowing.
2. We recovered from the depression of 1921 while reducing Government expenditures, and Government debt.

3. The greatest increase in business activity occurred from March 1933 to July 1933, when our fiscal actions were sound.

4. "Can society lift itself by its bootstraps through continuous spending in excess of income?"

5. Finally, it is maintained that experience in the past five years has demonstrated that a compensatory fiscal policy has been a tragic failure and that business turned down in 1937 despite an increase in public spending. "For every dollar the government borrows and spends in pump priming, private enterprise is deterred from spending two".

When your arguments bearing on the main issue are assembled as above, their thinness and inadequacy become palpable. You do not even attempt to assess the conditions making for prosperity in the Twenties and the basic changes that have occurred in this country and throughout the world since 1929. You do not ask yourself why a determined effort to pursue your policies from 1929 to 1933 was accompanied by such disastrous consequences. Nowhere do you discuss the importance of excess productive capacity as a factor bearing upon new capital expenditures, and the possible significance of this fact in accounting for the difference in English and American experience. England's national income declined only ten percent while ours declined fifty percent in the depression, so that the degree of idle plant capacity in the two countries at the bottom of the depression differed enormously.

You are reduced to linking up the boomlet in 1933, which was mainly inventory buying in anticipation of higher prices, with the "sound fiscal action" of that time. This apparently has reference to the economy measures in the ordinary budget, and ignores the then projected \$3.3 billion extraordinary expenditures for public works, the departure from gold and the N. R. A.

To your next point, the rhetorical question, "Can society lift itself by its bootstraps through continuous spending in excess of income?", I would suggest that we are here dealing with economics, not gravitation. As I pointed out above, national income and

national spending are two aspects of the same thing. We can never have an increase in the sum total of our collective incomes without an increase in the sum total of our collective spending. If anyone doubts this elementary statement, let him consider what would happen to incomes if everybody, including the Government, stopped spending.

I come now to the last point, the alleged failure of the policy of stimulating private expenditures through the Government contribution to consumer buying power. This was made in your speech in Boston on December 10th and rested on the view that the number of unemployed at the close of 1938 was "not so many less than when the depression began". I assume you meant when the recovery began. The number of persons employed, both on full and on part time, was 36 million at the beginning of 1933 and the most recent figure is 44 million. By the spring of 1937 the number employed had risen to . The national income was running at a rate \$30 billion or 75 percent higher than in 1932. It was perhaps considerations such as these that led you to concede in your later reply to me that there had been a recovery since 1933 even though "artificial", and that it was attributable to the Government's fiscal policy, though it is quite impossible to reconcile this with the \$2 decline in private spending that is supposed to result from every \$1 of net Government spending.

You next undertake to refute my statement that a contributory factor in the downturn in business in 1937 "was a too sharp and too rapid reduction, amounting to more than \$3 billion, in the Government's net contribution to community buying power in 1937 as compared with 1936". You do this, first, by quoting figures relating to the bookkeeping deficit in the fiscal years 1937, 1938. I was explicitly referring to the cash deficits in the calendar years 1936, 1937. You then bring in even more irrelevant figures purporting to show an increase in total (not net) expenditures of all public bodies in the fiscal year 1938 over the fiscal year 1937 of \$1 billion. Not only are the figures irrelevant for the purpose of throwing light on the causes of the decline in consumption that occurred in the first half of 1937, but they are inaccurate. They are apparently based on an estimate of non-federal public expenditures of the fiscal year 1938 made a year and a half before the close of the fiscal year to which the figures refer. Subsequent events have indicated that they were much too high. In any case, any additional expenditures of state and local bodies were more than covered by additional tax collections, since non-federal public debt retirement amounted to \$116 million from June, 1937 to June 1938.

It is, perhaps, natural that you should make no reference to my statement that the federal government ran a cash surplus of \$100 million from July 1937 to March 1938, inclusive. According to your theory that should have been a time of rapidly expanding private



expenditures, whereas the remainder of 1938, when the Government was again contributing to buying power, should have witnessed a decline in private spending. The exact opposite, of course, occurred.

In assessing the recovery program as a whole, I think it is worth pointing out that the deficits of 1931, 1932 and 1933 resulted more from a shrinkage of federal revenues consequent upon a decline in national income than from an expansion of federal expenditures. The deliberate policy of increasing expenditures to stimulate buying power only took effect in 1934. In the four years, 1934-37, inclusive, the sum of the annual excess of principal cash outlays over cash receipts of the Treasury (including payroll tax collections) amounted to \$14 billion. The sum of the increases in the national income in this four years' period over the level of 1933 was \$70 billion, as contrasted with the sum of the decreases in the previous four years, from the 1929 level, of \$122 billion. <sup>Insert-</sup>  
(See Page 8a)

Confronted with these figures I do not see how it is possible to question either the efficacy of a compensatory fiscal policy or the disastrous consequences of a failure to recognize changed conditions. Judging from the response to the new program launched in 1938, the results should be as gratifying as from the program launched in 1934, particularly as we started from a much higher level of utilization of plant capacity in 1938 than in 1934.

Evidently, as applied to the period 1934-37, it would be more true to say that for every dollar the Government borrowed and spent, private enterprise was induced to spend \$5 additional rather than, as you claim, \$2 less.

I have, I hope, demonstrated that on the main issue, the necessity and efficacy of fiscal policy in stimulating recovery, in the conditions confronting us in recent years, your resort to false analogies, authorities, maxims and irrelevant and inaccurate statistics, together with your failure to consider new conditions confronting our economy since 1929, do not make out a case. I gather, however, that you are not so concerned with the efficacy of a compensatory budget policy as you are with the subsequent dire consequences you believe will follow from such a policy. These consequences are associated, in your mind, with debt, taxes and inflation.

As a starting point in this aspect of the discussion, I find that I can accept your statement that "debt in itself is not evil; it depends upon the purpose for which the debt is contracted, the ability to pay, and whether the debt is essential". Let us apply these tests to the increase in the public debt since 1932.

I need spend little time in justifying the purpose for which the debt was contracted. Surely no purpose is more defensible than the preservation, protection and improvement of our physical and human resources of all kinds for which the debt was incurred.

With reference to the ability to pay, we may consider both the carrying costs and the repayment of principle. The interest charge on the federal debt amounts to only a little over 1 percent of the national income and that is the debt that is of primary

concern in this discussion. Adding in state and local debt, which has not increased since 1932, the figure becomes . Taking the net interest burden of all debt, public and private, we find, according to the Department of Commerce national income estimates, that it amounted to considerably less in 1937 than in 1929, in absolute terms, and to little more as a percentage of the national income, the figures being 6.3 percent and 6.7 percent respectively. The percentage in 1932 was . Certainly we did not feel oppressed by the interest burden in 1929.

As for the repayment of the debt, you apparently did not grasp the significance of my remark that we owed the debt to ourselves, and not to a foreign country. You state that we have placed a mortgage on all the people and on the property of all the people which our children will be required to pay. Pay to whom? Obviously to our children. As a result of our policy, our children will owe themselves more money. More important, however, as a result of our policy, our children will be more healthy, better educated, better skilled, better housed, and will inherit an improved and extended productive apparatus than if the human and material deterioration of 1929-32 had been allowed to persist. If you insist upon a bookkeeper's approach to the measurement of economic wellbeing, you should at least include the relevant things in your ledgers.

Let me here correct your impression that I said the public debt need never be retired. What I plainly said was that "when there is

contraction of total debt, private and public, we have deflation" and that "we have never had prosperous conditions without an accompanying expansion of debt, either private or public, or both". We can and should retire our public debt when, as and if, private debt is expanding at a sufficiently rapid rate to make this possible, and particularly if private debt is expanding at so rapid a rate as to result in inflation. This is nothing to get emotional about, or to praise and blame. It just happens to be a sober statement of an economic truism which will remain true so long as a large proportion of our annual savings are restricted to investment in debt.

This leads me to the final test laid down by you in appraising the goodness or evil of debt, namely, whether the debt is essential. It would seem obvious that (a) if savings that are unspent cause a contraction in the effective demand for goods and (b) if a large portion of savings are restricted to investment in evidences of debt, (c) if, owing to deficient consumer buying power and consequent idle plant capacity, private enterprise will not borrow enough to offset accumulating savings; that if all these things are true, then it follows that the incurring of debt by public bodies is essential if we are to sustain and increase national income.

One point made by you with reference to debt is particularly astounding and, considered from one point of view, disquieting.

You state, "A private debtor enters into the promise voluntarily, upon his own notion, and for his own interest. The government creates the public debt, and those who must pay are compelled to pay whether they would have entered into that promise or not". I find myself in the embarrassing position of having to tell a United States Senator that our country is a democracy with a representative government, that you are an elected representative of the people, that our theory of Government assumes that the representatives of the people will carry out the will of the people.

On the question of taxes, you repeat your charge that "high taxes retard business expansion and prevent the employment of the unemployed". I may again point out that this has not proved to be the case in England. Insofar as taxes are siphoned immediately back to the community in Government disbursements, no diminution in buying power results. Indeed, if the taxes so disbursed come out of money that would otherwise not have been spent, the effective demand for goods is to that extent greater than it would otherwise have been. The repressive effects of the greatly increased tax collections in 1937 arose from the fact that a large proportion came from payrolls, while at the same time government expenditures were tending downward.

You quote my question, "Would you have the public believe that the country was better off in 1932 with lower taxes and a lower public debt than it was in 1937 with higher taxes and a higher public debt?", and reply, "That is not the point" because

"the public might well believe that they would be better off with the low taxes and the lower debts in 1932 and the higher national income in 1937". Until you are able, in the light of the policy followed from 1929 to 1932, to offer a convincing demonstration that it would have been possible to secure a \$30 billion increase in incomes without an increase in debt, I must insist that my question is very much in point.

One of the dire consequences which you believe will follow from a succession of Government deficits is inflation. In support of this view you quote from one of my speeches in 1936 and again from a statement made by me in early 1937. You are under the impression that I have been inconsistent, failing completely to appreciate that the theory of a compensatory fiscal policy may call for the incurring of debt at times when private debt creation is insufficient to furnish an outlet for savings, for a balanced budget at other times, and for debt retirement at still other times to compensate for excessive debt creation. The passages quoted by you had, of course, reference to a future period when I feared private debt creation might proceed too rapidly.

It is not I who am inconsistent. How can you reconcile the fear of inflation from government borrowing, that is, a period in which for a considerable time the demand for goods outstrips our capacity to produce goods so that prices continue to rise, with your professed view that for every dollar of net expenditures by the government private industry is deterred from spending two dollars? Government borrowing cannot have both a negative effect and an excessive

positive effect on private spending.

Another of the bad effects you believe arises from Government spending may be seen in your earlier statement that "millions of able-bodied citizens rely upon the Government for support and have ceased to exert their efforts for self-help to obtain private employment". I am glad to note in your letter to me that you have now withdrawn this sweeping accusation by changing the word "millions" to "many". You have chosen to interpret my protest against your sweeping accusation to mean that I am "satisfied with the present administration of relief". This, again, is too sweeping. Personally I should like to see more emphasis on the work aspect of the program and less on the relief, and in this I differ sharply with you. I am, however, sensible of the enormous administrative difficulties attached to the adjustment of an efficient work program to the wide fluctuations in private employment.

So much for the main issue of securing full employment and the secondary issue of the consequences of Government borrowing. In conclusion let us examine the implications of this discussion for current policy.

My position clearly implies the stimulation of consumption until a sufficient volume of idle plant capacity has been absorbed to induce large private capital expenditures. The increase in incomes will also stimulate capital expenditures on housing. Whatever else that can



be done to stimulate capital expenditures should be adopted. A good example of the possibilities here is afforded by the amendments to the Federal Housing Act last year.

The transition from an induced to a self-generating recovery involves a delicate problem of timing. Clearly we should avoid too abrupt a transition. The reduction in the contribution to buying power by the Government of \$3 billion from 1936 to 1937 was obviously too large in relation to the expansion of private capital expenditures then taking place. The safest course appears to be one where the gap between Federal cash expenditures and receipts is closed mainly by the growth of tax receipts from sources other than those that are at the direct expense of consumption. In this connection it should be borne in mind that an increase in payroll tax collections has probably as great a repressive effect on consumption as a reduction in work relief expenditures.

The problem of timing is admittedly difficult. We will, however, have gone a long way to its solution if we can secure a wide public recognition of the nature of the problem.

The logic of your position would appear to call for drastic and immediate reductions in Government expenditures. Such phrases and sentences in your Boston speech as "fiscal insanity", "a pay-as-you-go plan in this country may bring to us the advantages that Great Britain now apparently enjoys", "to dismantle and reduce

this gigantic bureaucracy is a task of overwhelming proportions but the record is the preservation of sound Government and to prevent inflation", etc., and your later statement with reference to the deterrent effect of net Government expenditures led me to believe that you actually favored drastic reductions.

In one portion of your reply to me, however, you protest that you that you had in mind only "a gradual approach to a balanced budget" with the "ultimate" objective of restoring the country to sound principles of finance. Apparently, therefore, with respect to current policy, we have no fundamental disagreement, though I still find it difficult to reconcile your position with the logic and tenor of your previous statements.

After having attributed to me Caesar-like obsessions, the beliefs that for their own sakes debts and deficits are good, that the public debt need never be paid, and other beliefs I have never held, you will forgive me if I feel that your expression of confidence in my sincerity is a barbed compliment. In view of the gravity for the well-being of our country of the issues at stake I had hoped that the points I raised would be considered objectively by you. While I regret that this was not the case, I am nevertheless disposed to believe that the discussion as a whole has served to illuminate what we both regard as the major public issue of the day.

Very truly yours,