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Informal Remarks Regarding Present Day Conditions

By Ralph E. Flanders, President of the Federal Reserve Bank of Boston

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"It has seldom been my lot to be introduced twice. My first introduction came from Colonel Pope, who spoke about the man from Vermont who talked and didn't say. (Laughter) I hope not to give a 100 per cent performance of that first introduction, but if you find it is a 50 per cent correct introduction, do not be too badly surprised.

I have not, of course, a large background of banking experience, and that makes it perhaps a bit unusual that I should be president of the Federal Reserve Bank. But I want to talk a little bit about some of the opportunities which I see in our Federal Reserve Bank here in New England. I am not able to go into details as yet, but I do hope and I shall work toward making that institution a service institution to the banks of New England in some directions that I shall describe.

First, I want to paint a little picture of the background of the next few years, as I see it, and it is a rather troublesome and, in some respects, a rather terrifying background. We will have a national debt of somewhere between 250 billion and 300 billion dellars at the war's end, and will probably add to that somewhat in the year or so following the war. We hope that the additions will not be great. We hope that we will move early toward a balancing of the budget. But that balancing will not be easily or quickly obtained, and it will not be entirely along the line of cutting down expenditures.

The Post-War Budget

In the last few months there have been at least two careful examinations made of the post-war budget. Doubtless there are others which have not as yet been made public. One of the two to which I will refer has not been made public.

In fact, I am not sure that the other has been published, although it will be shortly.

Professor Crum, of Harvard, has been engaged in research for the National Bureau of Economic Research, and it has been difficult for him to come to the conclusion that we will be able to keep our post-war Federal budget very much below 25 billion dollars a year. That is a rather disturbing estimate of what we will have to endure in the way of Federal expenditures in the post-war period.

Another survey which has been made under the auspices of one of the foundations is much more conservative. It runs somewhere around 17, 18 or 19 billion.

I believe there is also a third which comes to about the same figures, on which experts in the employ of the Finance Committee of the Senate have been working.

The dilemma we face in trying to reach a balanced budget at the war's end is this serious dilemma that taxes are going to be very high indeed. They will be so high that it is going to be difficult to take out of our business and personal incomes the volume of money necessary. In the very taking out of that volume of money we may be faced with reducing business activity, reducing employment, and reducing the sources from which we draw those taxes. That is the serious problem which faces us in the coming years, of maintaining a sufficient volume of production so that we can withdraw the heavy taxes required to balance the budget without destroying the source from which we draw those taxes.

The volume of net national income which would seem to be required will be somewhere between 120 billion and 140 billion dollars annually, far higher than we have ever produced in peacetime. That is, naturally, a serious problem which faces us, and a very high production is going to be necessary to balance

our post-war budget without the imposition of taxes which will make the balancing impossible.

I will just say a word or two with regard to the nature of the taxes which will be required even with that high production. They must evidently be of the sort which does not restrict production. That means that the taxing of business will have to be very greatly reduced. Our present taxes on business in a private economy are of the sort which will reduce business activity, will reduce employment and will reduce the income which we must depend on for the

Concerning Taxes

The Committee for Economic Development, with which I have some connection, has been working on the plan of having the normal taxes of individuals and of corporations the same, with some means of seeing to it that there is no duplication, that is, that dividends are not taxed twice, once as corporate income and again as individual income.

Of course, we can only tax people. When we speak of taxing a corporation we are really taxing the owners of that corporation. If we keep clearly in mind the fact that you can only tax people, that you cannot tax corporate entities of themselves without taxing people, there appears immediately the inequity of the double taxation to which dividends are now subject.

As I indicated, the matter of equity, while important, is not the really serious thing. The really serious thing is leaving business free to expand, free to put its earnings back into the expansion of employment, free to be an attractive place into which to put personal savings as well as corporate savings, free to employ more and more men and produce more and more national income. As Sumner Slichter, ever at Harvard, puts it, we must go as lightly as possible on job makers and expect to get most of our Federal income from job takers rather than from job makers.

That is the background of some of the things that I would like to say about New England, of which Massachusetts is the largest, most prominent and most productive segment. I should speak of New England generally, but what I have to say, of course, applies very largely to Massachusetts.

This Federal Reserve District No. 1, which comprises most of New England except a little corner down in Southwestern Connecticut which is hitched on to New York, is in the main a region of small industries. There are some branches and some headquarters of national industries in New England. We think of the General Electric and we think of the United Shoe Machinery Company as New England industries. United States Steel has an important plant in Worcester, and there are some other segments of nation-wide industries in this region. But they do not compose anywhere near the majority of New England industry, and typically this whole region is studded with medium-sized and small enterprises. It is on the health of these medium-sized and small industries that this region must depend in the main, so far as industry is concerned.

The Situation in New England

Again, there is a peculiarity of this region, as the result of which I think there is less that is going to be automatic in our prosperity here in New England than is true of most of the other regions of the country. I have at home a picture puzzle map of the United States and it shows on it no part of Canada and no part of Mexico. When you put together this picture puzzle you see New England sticking way out to the northeast, and it is out on a limb. It is not in the center of any big market region except its own; it is not in the center of any great region where raw materials are produced. It is away out to the Northeast and will thrive or will go down hill strictly on its own ability and on its own enterprise. Speaking largely, it is not

going to be helped any by geographical considerations or any considerations of large natural resources. What we do up here in this Federal Reserve District No. 1 that is sticking out on a limb, will be entirely in the hands of us who live here. Nobody is going to help us very much.

Some months ago I listened to one of our foreign ambassadors who had talked with a member of the British cabinet who was present at the meeting at which the decision was made to withdraw the British forces from Belgium.

The story he told me was that Mr. Churchill described in detail the things which were happening to the British Army, the way the Germans were advancing, the almost dead certainty of being cut off; and as he went on, piling up one disaster on the other, the report was that the heads of the various members of the British cabinet sank lower and lower until they were practically prostrate on the table. But Mr. Churchibl wound up his tale of terror by saying, "As for me, I find the situation decidedly stimulating." Without looking at our situation here in New England in terms of terror - for we have no reason to do that, I think we should at least take that dictum of Mr. Churchill's, that the situation is decidedly stimulating.

People Are Its Resources

I said we had no large natural resources. That was an error. I did not state the truth. We have one very great natural resource here in New England, and it is the natural resource on which we have depended in the past and on which we will depend in the future, and that is the natural resource of our men and our women, of our boys and girls.

I am not so familiar with some of the other segments of the national economy as I am with manufacturing in the metal trades of all sorts, with which I am fairly familiar the country over. I cannot go through the industrial establishments of the Middle West, or of the Coast, or of the South, without mentally comparing the caliber of the workmen in those plants

with those who are to be found in any one of our New England industries. Furthermore and in reverse, when visitors from other parts of the country come to our region and go through our shops, the comment is almost universal that we have a higher type and more intelligent-looking group of people working in our industries than they have in whatever region they come from. So that is our resource. That is the thing on which we have to depend. I am sure we will find that to be solid, substantial and firm foundation, and our part is to build wisely on that human foundation which we have and in which lies so large a measure of our strength in this part of the country.

This has all bean generalities. As to some of the things we can possibly do I am still going to speak more or less in general terms, because ideas and plans are under discussion and are being worked out; and I want to speak particularly of the part which it seems to me the banks of this region can play and must play in this maintenance and expansion of New England's prosperity and production, which will be an important part of that 140-billion-odd of net income which the nation will have to provide by some means or other.

In the last few weeks the directors of the Federal Reserve Bank have been discussing a number of possibilities and they are not brand new ideas at all. They are ideas which have been discussed in the past. They are ideas on which committees and so forth have been set up in the past. Some of them are ideas at the present time under active consideration by the American Bankers Association. I was glad to hear the report given just before I stepped up here, of the increase of interest in that organization that has come with Mr. Wiggin's presidency. His type of thinking and his way of going at things are an essential part of the renewed approach of courage and enterprise which the banking system of the country, step by step

with industry and trade and agriculture, will have to display if we are to solve successfully this post-war dilemma.

We had three possible groups of activity in our mind and we are setting out to have committees on these three subjects which, as I say, are not new subjects - they are old subjects, which are of much more importance than they have been before. They are particularly important for our region and they take on particular importance in view of the post-war situation which we are facing.

Business and Character Loans

One is the means by which banks - and I am thinking particularly of the provincial banks or the banks other than the big city central banks - can best serve the industries of all sorts located in their regions. In that respect we will want to take wholeheartedly into consideration and co-operate with that plan on pooling resources for the support of industry which has lately been undertaken by the American Bankers Association.

In addition to that there are a great many problems, of the smaller banks in particular and, to some extent, of the larger banks, which need to be cleared up. Some of these situations are brought about by the new rigidity of bank examinations and the question of character loans, which it is difficult for the traveling bank examiner to take into account. He does not know the people and he does not know the conditions. In the olden days a local banker thought of character as his principal determinant in making loans. To a large extent he is no longer able to use his judgment as he once was.

There is the question of slow but good loans. As to slow but good loans, if they are good and if they are slow, both of those things make them pretty good loans from the bankers standpoint. If they are good and short and quick they are good as long as they last, but they do not last

very long. There are other questions in regard to the investments in the bank portfolio which I think can be studied and recommendations made.

So far as the Federal Reserve System is concerned, the point which I think presents the best possibilities for the Federal Reserve Bank, as distinct from other ways of getting at it, is this, that if from a little study we conclude that we can make definite and useful recommendations, those recommendations can perhaps find themselves in agreement with similar studies. and similar convictions in banks in the other districts of the country, and by working all together through the Federal Reserve System it is possible that we can bring more effective influences to bear upon whatever restrictions are imposed on us from above, than can be brought to bear by individual banks or individual regions working on their own. In that respect we can perhaps supplement and add to the influence of the American Bankers Association.

There are, in other words, possibilities here in New England, I feel sure, of generating good ideas, of backing them with reasonable and convincing analysis and, by working on a large scale, we may have perhaps a more reasonable expectation of having some of them adopted than would be the case if we went at the problem on a smaller scale and by a multitude of individual plans and suggestions.

Agricultural Loans

Another of the areas which we are planning to investigate is that of agricultural loans. Here, as in the case of small industries, for that matter, we have government competition to consider. Government institutions of various sorts are moving in on both of these areas, have moved in and have accupied some sectors of it for a good many years.

Coming from Vermont as I do, the question of agricultural loans has been one that has interested me for some time. I have talked quite a bit with local bankers and with farmers. I am convinced that were it possible to give the same service, the farmer would rather deal with the bank than with the government. There is a whole lot of red tape connected with government loans. They are more burdensome to service, from the borrower's standpoint, than our bank loans.

There are a number of types of agricultural loans, some of which, I think, are going to be of increasing importance in the years to come. There are the production loans or the crop loans; there are equipment loans and there are old-fashioned farm mortgages - the loan of funds to purchase a farm or to add to the buildings or the equipment.

I have been particularly interested in the equipment loans, because it is my belief - and conversations with Secretary Wickard and others have strengthened my belief - that we are coming to a time in the next few years which will show a revolution in farm machinery. We are at a point new, particularly with the development of the Ford-Ferguson tractor and some developments of the International Harvester Company, which will doubtless be followed by the other agricultural implement companies, in which the necessity for the horse will completely disappear, even from the small hillside New England farm. And there will be other equipment of that sort to the extent that that change is economically feasible. The whole point of the thing is that it now appears to be economically profitable to depend in a very much larger measure than ever before on the completely mechanized farm.

These loans will be fundamentally sound in a large percentage of the cases. At least there will be a very large new volume of fundamentally sound agricultural equipment loans in the next few years to come.

One of the things we have been doing is to let the farmer finance his equipment through the regular credit company and then the credit company may sell its paper to the local bank at some fraction of one per cent. The question is whether the country banks can go into the retailing business instead of the wholesaling business. It would seem as though there was a margin there for local financing in the cases of sound loans, as between the paper which the bank buys and the interest which the credit company charges, and that there was an area there for intelligent enterprise. That is one of the areas which our agricultural committee hopes to investigate.

Housing Loans

There is a third area, which we are only thinking about and have not started to organize. It is that of housing loans. There will be an enormous expansion of building of all sorts, all the way from slum clearance on a large wholesale scale down to the building of the low-cost dwelling house for the individual at the retail end of it. This will be a field in which we may hope for profitable and safe loans, and it will be an expanding field at least for the next five to ten years.

Old-fashioned Banking

In conclusion I want to present from another background or another approach entirely, this whole thing that I have been talking about. The whole banking structure, clear from the Atlantic to the Pacific and from the Canadian boundary to the Mexican boundary, has come to depend to an everwhelming degree on its returns from government paper. The portfolios of governments are very large. The portfolios of assets of the old-fashioned straight banking sort have shrunk pitiably in proportion to the whole. It is my conviction that if that situation continues we are going to face a political problem which will be a major problem and which might

conceivably ruin the private banking system unless we do something about it. I think the possibilities of the situation are obvious.

From time to time we hear on the floor of Congress, particularly from the floor of the House, questions as to what services the banks render simply by dumping in pieces of paper and drawing down so much from the government. The criticisms and the questions raised will lead inevitably to types of legislation for the banking system of the country, which will be exceedingly radical and which may conceivably, or almost certainly perhaps, lead in the long run to unsound fiscal, financial and bank policies, conditions which can hit us very hard indeed. Unless bankers are active in trying to regenerate the old-fashioned banking business and in being of banking service to their communities, their industries, their agriculture and their housing, and in finding ways of going back to the community with service as the main source of their income, these changes are going to be felt. We must so modify or so develop our whole banking activity as to withdraw the basis for the criticism; or, secondly, if unfortunate legislation takes place, we must find ourselves prepared with a sufficient volume of the old variety of business to weather the storm.