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PREPARED BY

MARRINER S. ECCLES,

CHAIRMAN, BOARD OF GOVERNORS

OF THE

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P7
P8
P10
P14
P18
P21

P15

CONTROLLING BOOMS AND DEPRESSIONS

A statement of the various important economic problems involved, and progress toward their solutions in terms of governmental policies which relate to the functioning of the economic system.

BY MARRINER S. ECCLES
Chairman, Board of Governors, Federal Reserve System

The time to prepare for floods and droughts is when there are no floods and droughts. Similarly, the time to prepare for economic disasters is when things are going smoothly. No one will deny that; but the regrettable fact is that we have made virtually no preparation for economic disasters in the past. As a consequence, when the crisis came we have had to rely upon hastily improvised measures that were necessarily defective in their magnitude, operation, and timing. I feel strongly that this must not be permitted to occur again. The very continuance of our individualistic profit system in economic life and of our democracy in political life depends on measures being taken in time to lessen the booms and the depressions from which we have suffered in the past. Since the pioneer period of our national life is over and there are no longer unlimited and untouched lands and resources to which men can turn when things go wrong, the problem of maintaining a stable and rising level of prosperity for our people is one that requires the most searching study and the most farsighted preparation.

Recovery is now under way, but if it were permitted to become a runaway boom it would be followed by another disastrous crash. There are forces within our economic system which, unless checked and counteracted by positive action, foster booms and slumps. It is my conviction that there are steps that can be taken by the government, as well as by private enterprise, that would greatly reduce the fluctuations of business and would make for a more stable and a more continuously prosperous economic life.

The problem

The problem of controlling booms and depressions is a major part of any country's economic problem at its broadest. The problem is to provide for the nation the largest possible real income, in terms of goods and services, and to have this income so distributed between current consumption and investment as to provide for a continuous flow of goods from farm and mine and factory to consumers. Stated in another way, the problem is to provide continuously for the people of our country as high a standard of living as can be derived from our resources. We usually think of our individual economic welfare in terms of our money income. This customary attitude should not make us forget the truism that for the economy as a whole the end of production is consumption, and that the economic welfare of the nation at large is determined by how much we produce and how that production is distributed. The importance of this truism is that it supplies a test which all economic policies, programs, schemes, and devices must meet.

It is apparent that the problem of achieving the greatest possible per capita production is partly a question of utilizing our human and natural resources as <u>fully</u> and <u>continuously</u> as possible and partly a question of utilizing them as <u>efficiently</u> as possible. Although these two aspects of the major problem overlap, it is helpful for the sake of straight thinking to make a distinction between them. The problem of preventing booms and depressions has to do mainly with the question of utilizing our resources as fully and continuously as possible.

American businessmen have devoted an enormous amount of attention to the problem of increasing efficiency or output per worker. Their success has won the envy and admiration of the world. They have, however, devoted relatively little attention to the problem of utilizing our manpower as fully as possible. They felt, doubtless, that there is little an individual can do about it. Recurrent depressions were accepted with fatalistic resignation as a necessary evil in a system that on the whole worked fairly well. The depression of 1921 was severe but it was easily explainable as an aftermath of the War boom and it was comparatively short-lived. The recession of 1924 was much milder and that of 1927 was barely perceptible. With the improvement of our industrial technique, the greater understanding of our economic system, and the strengthened financial structure under the Federal Reserve System, it was not an uncommon belief in the nineteen twenties that booms and depressions were a thing of the past, and that henceforth such fluctuations in business activity as would still occur would be of a minor character and perhaps salutary in weeding out unhealthy undertakings.

The developments of 1929-33 brought about a radical change in our sttitude. We found that all our technical ability and financial acumen were of little avail in the face of steadily shrinking demands for goods. The most efficient machine-tool manufacturer in the world could, for example, do nothing if he had no orders on which to work. The first aspect of the problem of securing national economic well-being was suddently thrust upon us in the form of widespread industrial stagnation and unemployment. We were, however, totally unprepared to grapple with it. Our first impulse was to apply the homely precepts applicable to our individual problems. There was talk of the importance of living within our means and of the importance of balancing the federal budget by curtailing expenditures. There was talk of the necessity of getting back to the old virtues of thrift, economy, and hard work. It was not appreciated that in the face of shrinking money incomes and expenditures any course of action that led to a further curtailment of community expenditures, whether it was increased saving or reduced government expenditures, merely intensified our difficulties and led to less utilization of our human and physical resources.

The fact of the matter is that, as many of us were forced by the logic of events to realize, the economics of the system as a whole differs profoundly from the economics of the individual; that what is economically wise behavior on the part of a single individual may on occasion be suicidal if engaged in by all individuals collectively; that the income of the nation is but the counterpart of the expenditures of the nation. If we all restrict our expenditures, this means restricting our incomes, which in turn is followed by a further restriction in expenditures.

As an aid in grasping this concept of a total community money flow of payments and receipts, the collection and publication of national income figures by the Department of Commerce, initiated in response to a Senate resolution introduced by Senator La Follette, have proved of inestimable value. In these annual compilations it becomes immediately apparent that the sums disbursed by industry and public bodies to wage earners, creditors, and, in the case of industry, to owners, are also the incomes received by individuals in the form of wages, interest, and dividends. From this it is but a brief step to the realization that, with allowance for physical capacity and price movements, money flows have their counterpart in goods flows.

The problem of preventing booms and depressions, therefore, is the problem of ensuring a flow of public and private disbursements just sufficient to call forth a sustained and well-balanced flow of goods and services. An excessive volume of expenditures results in widespread overtime work, inefficiency, and rapid price advances--an unstable and undesirable condition inevitably followed by reaction. An inadequate flow, on the other hand, results in the nonutilization of our human and physical resources and hence a lowered standard of living.

Why compensatory action is necessary

Having stated the problem in these terms, the question immediately arises: are there natural forces which, alone and unaided, are sufficiently powerful to bring about the right volume of public and private disbursements? If not, what instrumentalities may be utilized and what policies might be adopted to ensure that an adequate volume be maintained over a period of years?

The chances are exceedingly remote that unplanned and uncoordinated expenditures of industry and of all public bodies will be adequate, and no more than adequate, to provide for the relatively full utilization of our labor force over a long period of time. The number of things that can disturb the proper balance, if it should ever be attained, is legion. Some of these are adverse developments abroad, widespread strikes, overexpansion and collapse in important fields, excessive credit and monetary expansion or contraction, widening gaps between the effective demand for consumers' goods and their supply, between current savings and the opportunities for their profitable investment. The more the problem is studied the more one becomes convinced that the balance is extremely delicate and that departures from it can be caused by a host of factors; factors that are not remote possibilities but have existed in the past, exist now, and, so far as we can foretell, will exist in the future.

Those who believe in nature taking its course argue that there are forces that tend to restore the flow of income when it is disturbed. A rapid decline in one industry, it is thought, by lowering wages and interest rates and hence reducing costs, tends to stimulate expansion in other industries. A decline in security speculation likewise tends to lower interest rates. A fall in prices is believed to stimulate demand. And so on.

The answer to this argument is that it is true as far as it goes, but it does not go far enough. It assumes a condition of stable national income, and this is precisely the condition that is absent during a general downswing. When business as a whole is receding, a decline in one industry, with its accompanying reduction of wage, dividend, and other disbursements, far from stimulating other industries, may provoke or accelerate a decline in them. Similarly, in depressions, when incomes are falling, a reduction in prices may fail to stimulate demand. This is particularly likely to happen if a further continued fall in prices is generally expected. Thus a departure from stability, although it may set in motion corrective forces, also unfortunately produces intensifying and aggravating forces. Our recent experience is grim witness to the fact that these latter forces may far outweigh the corrective forces for an impossibly long period. Before the self-generating forces of deflation in the last depression were exhausted or were offset by positive government action, the national income had been cut in half and a sixth of our population was being supported out of public funds. Now that we are on the upswing, the self-generating forces of revival might carry us into another boom unless we are prepared to take corrective action in time.

There is a real danger, to my mind--and I say this not as a prophet of evil but as an advocate of stability--that the business and financial community may again be lulled into a false sense of security by the steady revival and by recent banking and security reforms. I do not mean to imply that we are experiencing a false or artificial recovery; neither do I wish to underrate the usefulness of new powers of government with respect to the regulation of security issues, speculation, and banking. Nevertheless, it is only prudent to recognize that too much reliance may be placed upon the remedial and corrective legislation of recent years. There are too many factors that can disturb the balance which have not been touched by legislation or which are not amenable to it. Of this I am convinced: unless we prepare ourselves now by developing the necessary machinery we shall continue to experience excessive fluctuations in business activity in the future.

To be forewarned is to be forearmed. Problems are never solved by being ignored. Let me state quite frankly, therefore, some of the possibilities that appear to me to be confronting us at the present time.

The most desirable course for business to pursue would be the continuance of a steady and orderly recovery movement, characterized by a steady increase in employment and production, and accompanied by little, if any, advance in prices. Such a movement would last longer than a more rapid upswing. And, at the end of the upward movement, our chances of transforming it into a period of stable prosperity would be infinitely better.

From 1934 to 1936 the upward movement was in fact orderly in nature, being characterized by a steady increase in employment and production. Government activity and expenditures were a main motivating factor in the movement. With the widespread existence of unutilized plant capacity and labor, increases in demand for industrial products were easily met by increases in supply without increasing prices. Sometime in 1936 and early 1937, with the increase in tax revenues and the decline in government borrowings, I believe that increased private expenditures in the production of durable goods became the factor of major importance; recovery became self-generating and proceeded under its own momentum.

This transition is significant not only from the point of view of the success of the government spending program as a recovery measure, but also as marking the beginning of a new period with new problems. The fact that durable-goods production is beginning to appear in substantial volume is an indication that a major part of our excess capacity of such goods has been taken up. Shortages of equipment and of certain types of skilled labor have developed. Speaking in very general terms, the transition is being made from a buyers' market to a sellers' market.

"We are, [redacted]e, faced with the paradox of deficient plant and labor in various fields at a time when there are still well over 8,000,000 unemployed." We need not expect the reemployment of all these people. Even in good times there is a more or less irreducible minimum of unemployment, due to seasonal factors, localized recessions, labor turnover, and sickness. It is variously estimated that the unemployment due to these factors amounted to some two million in 1929, or about 5 per cent of the gainfully employed.

With an increased population, with older people constituting a larger proportion of the population, we may perhaps anticipate that this figure will be nearer three million in the future. Although this reduces substantially the present apparent slack in the labor market, there is an offsetting factor in the annual new additions to the number of workers. Estimating this figure at 600,000 a year, it appears that the number of available workers will be increased by nearly two million in the next three years. The employment of over 7,000,000 people at current or higher wage rates will mean a higher national income and increased demands for consumer goods. The production of more consumer goods will, in turn, require more capital facilities. The shortages in plant capacities and skilled labor that are now appearing may, therefore, be expected to become more acute before they are lessened.

Although there are special reasons in individual cases, the broad explanation of the position confronting us is to be found in the long continuance and severity of the depression. For seven years we added little to our capital equipment or to our supply of housing accommodations. During this period, however, population had been increasing, the pattern of the community demand for goods had undergone some change, new products were introduced, and there was little actual physical embodiment in plant of technical improvements that had been worked out in the depression. Assuming a further increase in consumer demand, there will be a grave deficiency of capital goods and housing. It is estimated that in the field of housing alone an annual output three times that of 1936 will be required for five years to make up for curtailed construction during the depression and to accommodate needs currently accruing. This is the real significance of the question of accumulated shortages about which we heard so much in the depression. It is only with the rise in incomes and buying power that the shortages lead to an active demand and to actual investment. Accumulated shortages, in other words, are of major significance in the later and not the earlier stages of the current movement.

The bearing of the question on our main theme is apparent. It raises serious problems both in connection with the maintenance of an orderly upward movement without a material rise in prices, and the subsequent leveling out of this movement to a period of stable prosperity. After practical plant capacity has been reached, a further small increase in demand for goods results in a multiple demand for machinery and equipment to make those goods. In order to increase the annual output of consumer goods by an additional five billion dollars, for example, a capital investment of more than, and in some cases several times this amount may have to be made. Similarly, a small increase in freight traffic, under the same conditions of full utilization of existing facilities, will necessitate a large sudden spurt of expenditures for the construction of new additional track and rolling stock. This, in turn, will be reflected in increased activity in the steel and other material-producing industries. When the additional demand for freight facilities has been satisfied, however, a sharp decline in the production of further new facilities may be expected to ensue, with corresponding repercussions upon the steel and other durable-goods industries. Too sharp an intensification of production thus tends to end in subsequent relapse.

A further danger is that the demand for goods may increase too rapidly to allow sufficient time for the addition to plant capacity. Partly in self-defense and partly because of a semi-monopolistic position, businessmen may abruptly raise prices. Skilled trades may capitalize on their strategic position by demanding higher wages and shorter hours. Difficulty in securing goods on the one hand and price rises on the other may lead to duplication of orders and speculative inventory buying. This would magnify the apparent shortages.

Later, when the output of durable goods (including housing) has expanded to meet normal growth requirements plus the accumulated deficiencies resulting from the depression, the necessity will arise for making the transition to production to meet normal growth requirements alone. Should the accumulated deficiencies be made up in several important industries at about the same time, the problem of maintaining a steady flow of purchasing power may become serious.

Whether the course of business activity will actually be along the lines sketched above, is of course impossible to say. I mention it merely as a possibility for which we should be prepared. Other factors, such as widespread tie-ups due to labor difficulties, or developments abroad, may completely alter the picture. The point is that the prospects for an unplanned and "natural" period of stable prosperity are definitely unpromising. Stable prosperity can be attained only if we are aware of the problem, if we are willing to tackle it vigorously, and if we can develop a broad positive program designed to be corrective of economic distortion and unbalance.

Suggested types of action

I am convinced that the solution of the problem of securing greater economic stability cannot be solved by any single instrument. I feel that the problem is so broad and has so many ramifications, and the effectiveness of any one instrument or line of attack is so limited, that we must rely on the coordinated use of a variety of instruments, chief among them being our monetary, fiscal, foreign-exchange, labor, and price policies.

1. Monetary Policy. In view of the severity of the preceding deflation, the monetary authorities first pursued an active easy-money policy by purchasing a large volume of U. S. Government obligations, later by permitting incoming gold to increase the deposits and excess reserves of member banks, which in turn enabled them to take up substantial amounts of government securities and in the process create further new deposits. The volume of demand deposits and of cash outside banks has expanded some $12,000,000,000, or 60 per cent over the figure for June 30, 1933. With a rate of turnover equal to that of 1929 the present volume of money is sufficient to support a national income of more than $90,000,000,000 at present price levels. When the recovery movement appeared to need little further support and a volume of money adequate to meet the needs of a complete recovery had been built up, action was taken to set a limit on the rate of expansion of money. This took the form of two successive increases in reserve requirements, effective in August, 1936, and March to May, 1937, which, by absorbing some $3,000,000,000 of the excess reserves of member banks, removed a large part of the basis for further expansion. It is probable that most of the remaining $500,000,000 of excess reserves will be absorbed in other ways in the course of the year. Normally banks have a negligible amount of excess reserves. When we return to this normal situation, credit control measures will be felt more quickly and are likely to be more effective.

The Federal Reserve authorities, with the cooperation of the Secretary of the Treasury, have power to control and limit the expansion of reserves, bank loans and investments, and deposit currency. Under the Securities Exchange Act of 1934 the Board of Governors of the Federal Reserve System also has new powers to prescribe margin requirements "for the purpose of preventing the excessive use of credit for the purchase or carrying of securities." This is an important instrument of control to prevent a stock speculation based upon the extension of bank credit. (In 1929, it will be recalled, the credit extended to the market by banks to brokers and by others to brokers was about $9,000,000,000 as compared to less than $1,000,000,000 now.) The significance of this, as I see it, lies in the upper limit it imposes on the possible extent of business and price advances. So far as I know, there has never been a prolonged inflationary period that has not been accompanied and fed by an expansion of the means of payment. Monetary control is thus an indispensable instrument in controlling booms and depressions. This single instrument, however, has its limitations. Although upper and lower limits to business activity and price movements may be set by effective monetary control, the distance between these limits appears to be wide enough to permit fluctuations of such magnitude as to keep us far from our goal of stable prosperity. Hence, I regard it as vitally important that monetary control be supplemented by other methods and measures.

2. Fiscal Policy. Fiscal policy may be directed not only toward moderating and offsetting a decline in general business activity but also toward moderating the rate of expansion. Just as an excess of federal expenditures over tax collections tends to increase incomes, enables banks to

expand their investments, and, in so far as it results in the creation of new deposits, produces new buying power, so, contrariwise, an excess of tax collections over expenditures tends to restrain the growth of spending and to offset the expansion of private bank credit. Hence a full acceptance of the compensatory fiscal policy implies a willingness to run counter to private business behavior not only on the downswing but also on the upswing. "I have advocated heavy government expenditures during the depression and I advocate debt retirement now that recovery is definitely under way. Both attitudes are part and parcel of the same principle of compensatory action. The changed business picture calls for a different policy. But both policies are designed to achieve the same end, the end of moderating and offsetting the effects of fluctuations in the volume of private business enterprise."

"I have never believed and I do not believe now that the budget should be balanced and the debt retired at the expense of those who are jobless and still in want, but that when an adequate volume of money has been created and private enterprise is rapidly expanding, as at present, a balance should be brought about through increased taxation if the yield from existing taxation, including social-security taxes, and from liquidation of assets held by the government, proves to be insufficient to produce the balance and permit retirement of the public debt as private debt expands.

"Another reason for a reduction in the government debt in prosperous times is to make conditions more favorable for its increase in bad times. On fiscal grounds it is desirable that the federal debt be reduced to as low a point as possible so that there will be no hesitation in increasing it when the need arises. As the upward movement continues, therefore, provision should be made for retirement of the public debt."

In view of the probable resort to increased government spending when the necessity again arises, it appears imperative that a careful study of our recent experience be made. We have accumulated a good deal of experience on the relative flexibility and effectiveness of various types of projects which should prove invaluable in aiding us to prepare for the future. The feasibility of maintaining a perpetual inventory of desirable projects might be investigated. Some progress is already being made along this line. As a means of maintaining purchasing power it would appear desirable to investigate the feasibility of tying in a flexible public-works program with the unemployment-insurance program. Although the subject is complex and many difficulties would have to be overcome, the importance of coordinating the various compensating activities of the government appears to warrant serious consideration of this proposal. It would be a pity if the next downturn caught us as unprepared as we were in the last depression and we had to suffer the delays and mistakes attendant upon a hastily improvised program of public works and work relief.

3. Foreign Exchange Policy. A serious threat to securing and maintaining a greater measure of business stability at home is the possible emergence of adverse developments abroad. One lesson we have learned in recent years is that, at a time when the world is as badly out of balance as it is today, we must not permit ourselves to be tied to a rigidly automatic gold standard that makes us helpless against the impact of forces from abroad. At a time when incomes, prices, exchange rates, or confidence abroad are declining rapidly, raising the price of gold in terms of dollars or other action on the foreign exchange value of the dollar would relieve the situation.

Contrariwise, lowering the price of gold, or a relative fall in other currencies, might offer a possible means of checking excessive expansion at home. In any case it appears desirable that we should retain a large measure of executive discretion in the exercise of powers through which we can affect the value of the dollar relative to other currencies.

One factor in this connection that was probably helpful in the years 1934-35 may, if it continues to operate, result in difficulties in the future. I refer to the inflow of gold on foreign capital account. Although, owing to the cooperation of the Treasury, such inflowing gold is no longer permitted to result in an addition to the reserves of member banks it does result, so long as the government borrows from bank funds to buy the gold, in a corresponding unnecessary and undesirable expansion in deposits. Moreover, the addition to foreign balances either through the appreciation of existing holdings or from future inflows is a potential threat to the stability of our security markets, since foreigners, like Americans, buy on the upswing and sell on the downswing. They intensify a speculative rise of prices and accentuate a rapid fall. It is also to be considered that the existence of large foreign holdings in our markets constitutes a threat to our neutrality status and to domestic stability in the event of a war abroad. One of the most difficult problems of financing a war, that of securing purchasing power abroad, would be solved by the foreign governments concerned sequestering the property of their nationals in our markets as they have done before. The process of converting this property into cash and spending it would disturb both our commodity and security markets and would give rise to groups opposing a policy of strict neutrality.

In view of the prospects for a continued recovery here and the continuing political uncertainties abroad, future inflows of foreign capital may very well be in substantial volume. Since such inflows complicate the problem of achieving and maintaining prosperous stability, constitute a source of embarrassment to many countries from which the capital is flowing, and, in the present circumstances, have nothing to do with foreign trade or the international division of labor, there appears to be a clear case for adopting measures designed to deter the growth of foreign capital holdings in our markets.

4. Labor Developments. It is important that the share of the national income going to labor should be increased, either through decreased prices or increased wages, as rapidly as earnings of business and industry will permit without increasing the prices of their products. It is also obvious that stoppages of production, if they should become widespread and occur in key industries, would interfere with an orderly upward movement. Thus additional obstacles may be put in the way of the movement of goods through existing bottlenecks, creating an incentive for price rises and speculative inventory buying.

Problems of hours of labor should be carefully studied. Reduction of hours for the purpose of affording a reasonable amount of leisure has always been advantageous both socially and economically. Reduction of hours for purposes of sharing the existing volume of work, however, raises many intricate problems of relative costs, of increased shortages in individual lines, of losses in total output and, therefore, in national income. There is a danger that it may mean sharing poverty rather than sharing wealth.

The supply of work is not a fixed quantity any more than the people's demand for goods and services. Human wants are inexhaustible, and we certainly have enough wants, even of a reasonable and moderate kind, to keep all our workers fully employed for as many hours as our present state of economic and social development deems to be a full day's work. If sufficient purchasing power is provided there will be a sufficient demand to employ all available workers. There are excellent prospects that the increased disbursements of industry, particularly in the durable-goods industries, will supply this purchasing power.

Some thought might be given to the advisability of providing technical training in fields in which serious shortages threaten. This would not only further the objective of an orderly upward movement but would also result in increased total employment.

Another and very effective means of lessening shortages of skilled labor would be for the federal government and all other public bodies to defer the type of work requiring such labor when shortages develop. Such a course would also have the advantage of creating a backlog of work for the skilled when private business turns down.

5. <u>The Movement of Prices.</u> I have already pointed out the danger that the possible shortages in certain types of plant facilities and skilled labor may result in undesirable price advances, duplication of orders, and speculative inventory buying. It would obviously be very difficult to cope with such a situation by the use of monetary instruments. Such instruments are for the most part nonselective. In any case, as I have pointed out, the effectiveness of monetary control consists more in setting an upper limit to expansion. Our problem here is with the emergence of harmful developments

in particular lines before there is any general need to impose an upper limit. Similarly a compensatory fiscal policy is a comprehensive and over-all type of instrument not capable of dealing with particular cases of this kind and lacks the flexibility required to cope with short-term swings in a major cyclical movement. Both monetary and fiscal policies, however, and particularly the latter, may be operated in the direction of restraining the general upward movement so as to give more time for shortages to be met in various fields in which they occur."

In the case of excessive price rises on particular products in important fields, something of a direct nature might be done by effective anti-trust legislation and by reducing tariffs under the flexible tariff powers.

Reforms

I have indicated some of the things that might be done, or should be studied, with a view to moderating fluctuations. In conclusion I would refer briefly to the long-term problem of providing a more favorable background against which compensatory controls may operate.

Of the many institutional factors that contributed to the intensity of the depression a few may be singled out for discussion. It will be agreed by all that our banking system proved to be one of the weakest links in our economy. Nearly 8,000 banks failed. Total deposits shrank by $14,500,000,000 and deposits subject to check by $7,500,000,000. In the banking legislation of 1933 and 1935 much was done to prevent a repetition of this disgraceful record. Greater responsibility and authority for the determination of national monetary policies were conferred on a single public body; more ease of access to the lending facilities of the Federal Reserve banks was provided;

and the insurance of deposits up to $5,000 was instituted. In view, however, of the multiplicity of banking systems and of chartering and examining authorities, the inadequacy and, in many places, complete absence of banking facilities in country districts, it cannot be said that all the defects in our system have been eradicated. A major task of banking reforms still remains to be done.

Another dangerous spot in our system proved to be security speculation. The legislation of recent years should do much to correct the past abuses, make for a more orderly market, and lessen greatly the danger of widespread forced liquidation in the future. Similarly, we are in a better position now to minimize the effect on the domestic economy of adverse developments originating abroad than we were in 1929-33.

There is one factor that is much less obvious and yet is, I believe, of paramount importance in explaining the severity of business fluctuations. Wide fluctuations in the national income appear to be associated with the wide fluctuations in the expenditures on durable goods. Because these goods are durable, expenditures on them can be postponed. When the pantry is bare it must be replenished at once, but the obsolete kitchen range can always be made to do for another year. In a year of financial difficulty the railroads can decide to buy no locomotives, although they cannot decide to operate their locomotives without fuel. Thus the output of durable goods may undergo enormous fluctuations.

This fact becomes more significant as a community becomes wealthier and saves and invests more of its current income, since the great bulk of investment is, in the last analysis, associated with the creation of durable goods: new factories to produce new products, more efficient factories to produce old products, better homes, improved methods of transportation and communication.

As long as there are opportunities for profitable investment in durable goods, upon which investors can spend as much as or slightly more than the savers in the community set aside out of their incomes, the monetary circulation is not interrupted by this process. The businessman building an addition to his plant will put back into the flow of the community's income as much as the savers took out of it. As the community grows richer and its income increases, however, it becomes easier and easier for it to save. This is not only because there are relatively more well-to-do people who save a very large proportion of their incomes but also because the average man finds that his income is growing so that his margin of savings can be increased. It may then become a question as to whether businessmen can find enough opportunities for profitable investment to restore to the community's income this increasing volume of saving. If they cannot find such opportunities, a danger to prosperity arises, since the money saved may be kept idle or hoarded, or may flow into harmful speculative channels, bidding up existing values and thus interrupting the flow of the community's income and endangering the stability of employment, which is dependent upon that flow of income.

“In case such a situation of over-saving in excess of available opportunities for investment should arise, it might be met by two lines of attack. On the one hand we might seek to ensure that more of current income is consumed and less is saved and, on the other hand, we might seek to make conditions more favorable for investment.” The most promising instrument available to ensure that a large proportion of income is spent on consumption is--taxation. By providing that the expenses of the government be financed largely out of taxes on the higher and intermediate income groups we diminish the total savings of the community and hence the total amount seeking investment and threatening to remain idle, thus obstructing the monetary flow. The recently enacted tax on undistributed corporate earnings may be expected to increase the demand for the final products of industry. On the other hand, the present scale of taxes and benefits in connection with the old-age security program is likely to result in a substantial diminution in consumer buying power for a number of years.

Turning to the other aspect of the problem, that of providing favorable conditions for investment, the monetary authorities can help by maintaining relatively low interest rates. It will be borne in mind that I am here discussing a long-range problem. Looking ahead for some years I see no reason to expect that on the average long-term interest rates will increase materially above prevailing levels.

Conclusion

Such, in brief outline, is the positive program I would offer to meet the cyclical problem in the next few years and to provide a more favorable background for the attainment of a greater measure of long-term stability. Although various aspects of the program may be open to question, there can be no question as to the gravity of the problem and the need of a program. The fact that we are in the midst of a recovery does not for a moment mean that we have solved the problem of economic stability.

The problem today is as serious and as pressing as it has ever been. It can be solved only by knowledge, determination, and courage. It is my hope that the business and banking communities, which have so much at stake, will take a leading part in devising and supporting measures for its solution.

The President, in his inaugural address, recently emphasized the gravity of the problem. Let us, in his words, "refuse to leave the problems of our common welfare to be solved by the winds of chance and the hurricanes of disaster." Let us "not admit that we cannot find a way to master economic epidemics just as, after centuries of fatalistic suffering, we found a way to master epidemics of disease."