December 22, 1936. currie ?2

OUTLINE OF PRESENT STATUS AND PROBLEMS OF THE RECOVERY MOVEMENT

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2. The change in the character of the recovery movement.

3. Prospects for further recovery. (Accumulated deficiencies and normal requirements).

4. The problem now is to achieve an orderly upswing.

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December 22, 1936.

THE PRESENT STATUS AND PROBLEMS OF THE RECOVERY MOVEMENT

Progress to date

We appear to be about midway on the road to full recovery. It has been estimated that the national income produced will approximate $60 billion in 1936 as contrasted with $40 billion in 1932. If this proves correct the national income is probably running at the present rate of around $64 billion. It is a reasonable inference that with a further moderate rise of prices the attainment of a normal condition of employment by 1939 would correspond with a national income of from $85 to $90 billion. In other words, an expansion of $20 to $25 billion in the national income is to be anticipated in the next three years if we are to achieve normal employment.

The change in the character of the recovery movement

From 1933 to 1936 inclusive, the main factor responsible for the recovery movement was the excess of federal expenditures over tax revenues. This led to an expansion of money, an expansion of incomes, an increase in the demand for goods, and a secondary expansion of incomes. Business as a whole disbursed less than it received and added to its cash balances. During 1936, however, the movement began to acquire some momentum on its own account. Building construction and plant expansion and equipment have begun to assume significant proportions. It appears that, broadly speaking, 1937 will mark the transition from a governmentally-supported recovery to a self-generating upswing.

Prospects for further recovery

In relation to normal annual requirements an enormous deficiency in housing and in our capital equipment has accumulated in the past seven years. With the expansion of incomes that has occurred, the deficiency is beginning to be felt. The process of remedying this deficiency, which involves, in turn, an increase in incomes, makes possible and profitable further additions to our housing and capital equipment. The process, in other words, is self-generating. It is estimated that an average annual new production of some 800,000 non-farm housing units in the next five years will be necessary if we are to avoid a housing shortage by 1941. This may be contrasted with an estimated output of 250,000-300,000 units in 1936 and with an output of 900,000 units in the peak year 1925. The same general picture is true of many other important industries.

It would appear, therefore, that after the recovery has proceeded to a certain point, -- and that point seems to have been reached -- it has ample material on which to feed for a considerable time.

The problem now

With a change in the character of the recovery movement comes a change in the character of the problems with which we have to deal. It appears that henceforth the concern of the Administration and the monetary authorities will be not so much in stimulating a revival as in seeking to make the upswing as steady and as orderly as possible.

The more orderly the upswing and the less it is characterized by price advances and speculative inventory buying, the better the chances of avoiding a boom followed by a major slump. The problem of making a smooth transition from producing an amount of goods sufficient to make up the accumulated deficiency plus annual normal requirements, to producing for normal requirements alone, will tax our ingenuity and resources to the limit. The problem will become almost insuperable if the upswing is aggravated by excessive price rises and inventory buying.

1. Interest rate policy

The accompanying chart indicates the rapid fall in interest rates in the past few years. We have probably gone as far as is safe in this direction and if the upswing gathers momentum some firming of interest rates may prove desirable.

2. Monetary policies

The deficit-financing program and gold and silver inflows have together not only restored the volume of deposit currency wiped out in the depression but have caused it to exceed pre-depression levels. The volume of checking accounts and currency in the hands of the public now approximates $31 billion, a 55 percent increase in a little over three years, and some $5 billion in excess of 1929. Should this money be turned over at the pre-depression rate, a national income of $93 billion would result. It is, therefore, a reasonable assumption that the volume of money is now sufficient to finance full recovery and that, consequently, any further expansion now might lead to excessive spending in the future.

Since further increases in the money supply can be anticipated from an expansion of bank credit on the basis of excess reserves and from further gold and silver inflows, the remedy must be sought in action that would prevent or offset these developments. Expansion of private bank credit can be prevented by wiping out the bulk of the excess reserves, and, if need be, by forcing banks to borrow a portion of their required reserves from the Federal Reserve banks. Action with reference to excess reserves will shortly be considered by the Board of Governors.

Expansion of commercial loans can be offset by the Treasury retiring out of surplus revenues a portion of the short-term federal debt held by banks. This should be possible in the latter part of the fiscal year 1938. The most feasible way of preventing the expansion of deposits arising from gold inflows appears to be to check the inflow of foreign capital which is giving rise to gold inflows. This problem is now under study. The steady accession of deposits and reserves arising from silver purchases should be stopped by abandoning the silver purchase program. Finally, it may even prove desirable to have the dollar rise in terms of foreign currencies.

3. Banking policy

A higher degree of unification of banking and coordination of bank examination and chartering policies under a central agency is urgently needed. Conflicting examination and chartering policies and the constant threat of defection of membership from the Federal Reserve System impose obstacles to the effective exercise of monetary control.

4. Budget policy

Since it would appear that the recovery movement is no longer dependent on Government support, the budget should be brought into balance as quickly as possible. In addition, it is desirable that a period of comparatively rapid debt retirement be inaugurated as soon as possible in order that private credit expansion may be offset, the upward trend of business activity kept within bounds, and that the Government should be in a position to increase its borrowings later when and if the need arises. This requires that the present tax base should be retained and, if the upward movement appears to be gathering too much momentum, even extended.

5. Policy with reference to security and commodity speculation.

While excessive movements in prices on the security exchanges may arise from cash purchases and sales, they are greatly intensified by margin trading. The Board of Governors now has ample authority to control domestic margin trading. It would be desirable, however, to diminish foreign trading in our stocks and to devise methods of checking the evasion of margin requirements on the part of those Americans who are trading in our stocks through London. The stock market is now one of the parts of our economy most vulnerable to adverse developments abroad.

With reference to the commodity exchanges, consideration should be given to the desirability and feasibility of empowering the Board of Governors to determine margin requirements for trading in such exchanges and in this way reduce the fluctuations arising from buying with borrowed money and from forced selling.

6. Policy with reference to excessive price mark-ups.

It is desirable to restrict price advances to a minimum. Such advances lead in the short-run to disturbing fluctuations in inventory buying, and operate over a longer period to restrict employment and production. The aggregate of business inventories is so large that a small fluctuation of five percent amounts to some billion and a half dollars in production. As long as inventories increase in pace with the increase in production there is little to be feared. When, however, speculative inventory buying occurs because of actual or anticipated price advances, business activity is at first unduly stimulated and later, when inventories are being worked off to a more normal level, unduly depressed.

In order to restrain business from excessive price advances, resort might be had to the use of moral suasion. This in turn might be supported by more strict enforcement of the anti-trust legislation and by the threat, in individual cases, of tariff reductions.

If such measures should prove ineffective and unwarranted price advances occur on a wide scale, consideration should be given to a rise in the foreign exchange value of the dollar.

7. Policy with reference to shortage of key products.

It would be helpful if the Government took the lead in ascertaining and supplying information on the probable shortages in skilled labor and plant equipment. Something might possibly be done in inducing skilled building trades to relax rules relating to apprenticeship, etc., since there is reason to believe that the most serious shortage will occur in this field. Careful consideration might be given to the immediate inauguration of vocational training in the Civilian Conservation Corps, and in connection with the Works Relief Program, in those fields in which shortages are most likely to occur.

8. Policy with reference to adverse developments abroad.

Consideration should be given to the possibility of insulating our economy from adverse developments abroad in so far as such insulation is compatible with our domestic interests. More specifically, the power to vary the value of the dollar in terms of foreign currencies should be made permanent and the volume of foreign capital here should be kept as low as possible and further inflows be discouraged.

Conclusion

In general, it would appear that the program now should be one directed toward an attempt to make the upswing as steady and orderly as possible while at the same time preparing for the threatened recession when the accumulated deficiencies in housing and capital equipment are largely overcome. It is better to aim at relatively full employment in, say, three years' time, and in the meantime carry the unemployed, than it is to seek to achieve full recovery in a year or so! Otherwise, it may be difficult to avoid a boom and a disastrous slump.

The program would be greatly facilitated by full publicity as to its nature and purpose. The prestige acquired through the successful attempt to arrest deflation and bring about recovery will prove a most valuable psychological support for the program briefly outlined above. If business believes we can do what we set out to do, half the battle is won.

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A LONG-RANGE BUSINESS STABILITY PROGRAM

The foregoing suggestions are designed to cope with the problems likely to confront us in the immediate future. The longer range problem of retaining the prosperity we hope shortly to secure should not be neglected. This is the problem of maintaining a gradually increasing flow of purchasing power to the masses of the people. Once the accumulated deficiencies in housing and capital equipment are made up, there will be grave danger that the ever-increasing savings of the corporations and wealthy individuals will lie idle or be directed into unproductive channels, thus diminishing the flow of purchasing power to consumers.

At a later date I should like to offer a detailed and coordinated monetary and fiscal program whereby threatened interruptions to the flow of purchasing power may be prevented. I shall here merely indicate some of the aspects of that program.

1. The development of a flexible public works program to provide work for those who have exhausted their unemployment insurance benefits. This appears to be more socially desirable and a more effective means of maintaining purchasing power than the European development of longer and longer unemployment insurance benefit periods.

2. Postponed and reduced taxes for old-age benefits account. The present scale of taxes and benefits is such as to aggravate the long-term problem of preventing a deficiency in consumer

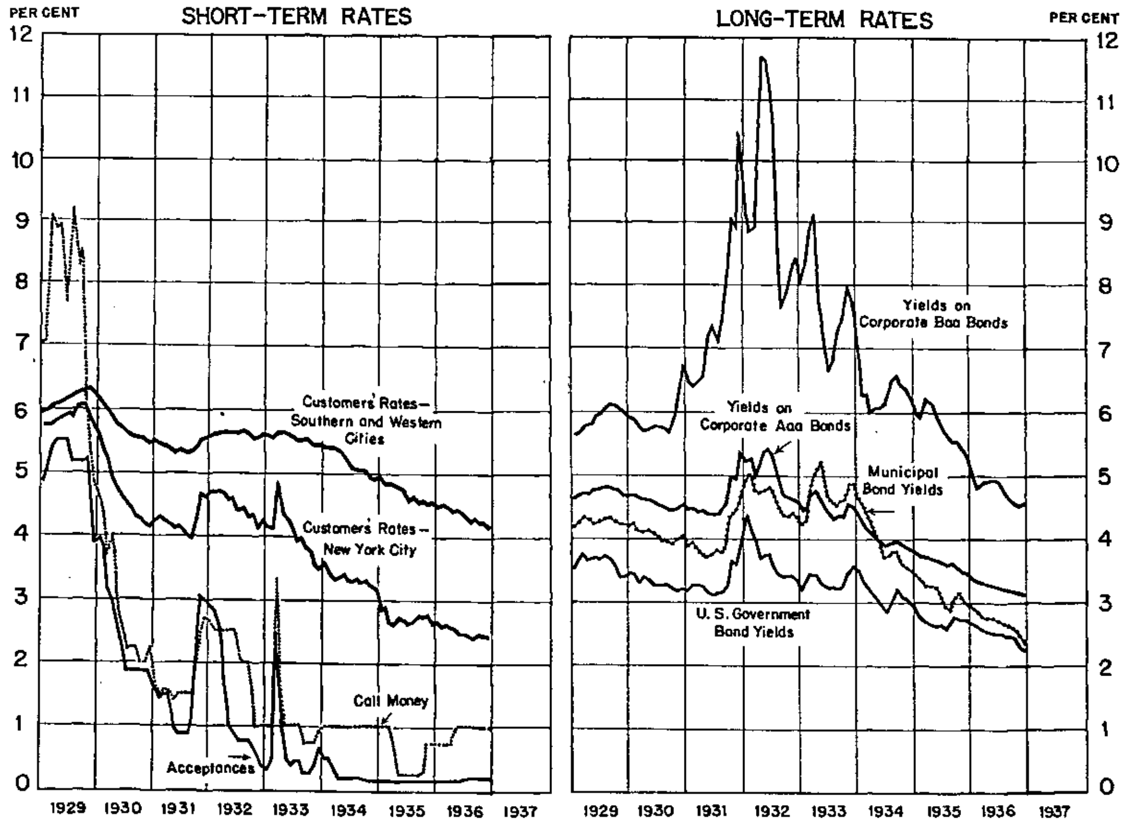
buying power.

3. A flexible tax program designed to facilitate a steady flow of purchasing power.

4. The continuance of monetary policies of a compensatory nature.

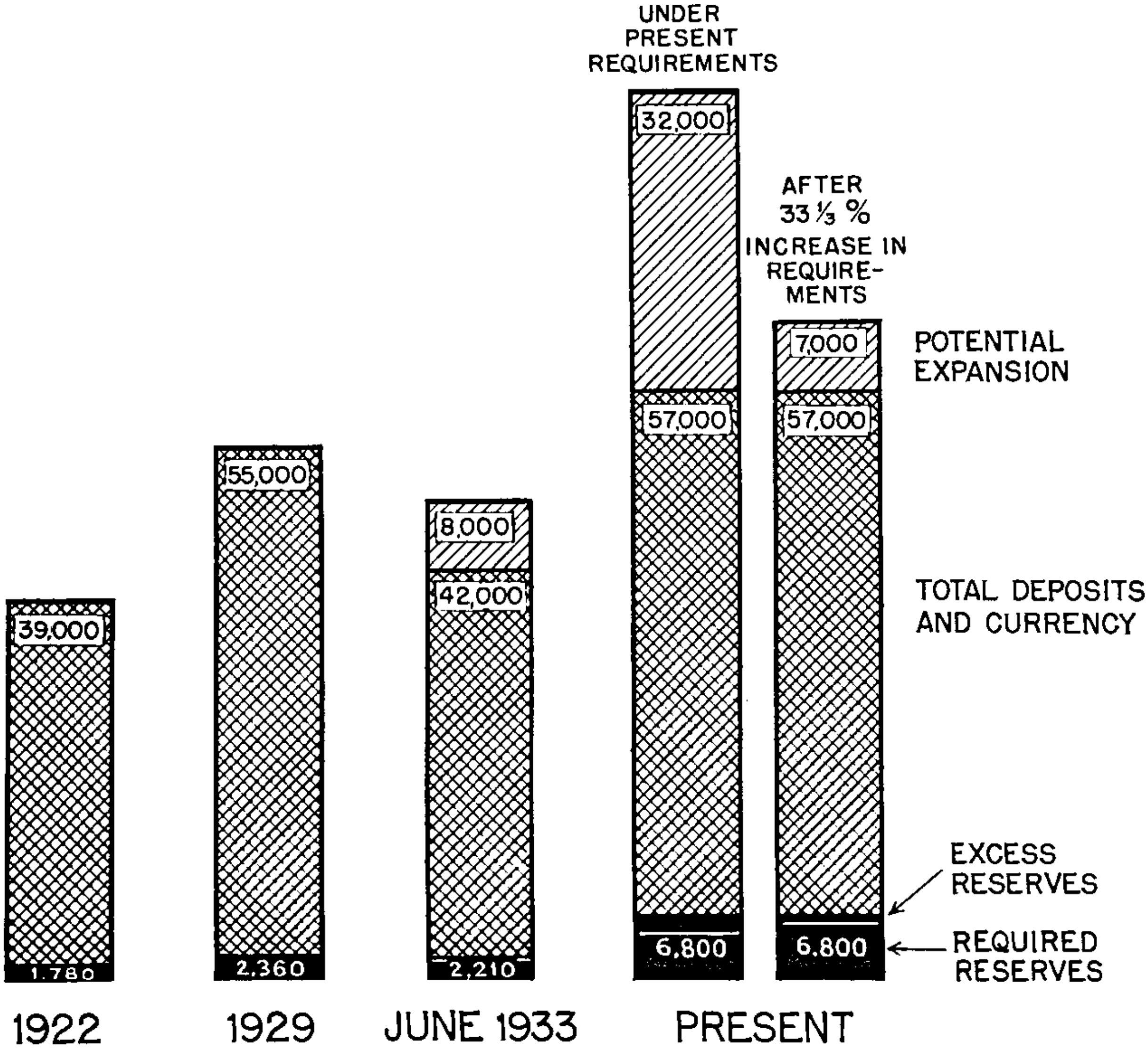
I feel strongly that the attainment of enduring prosperity rests in the final analysis on the development of compensatory controls by the Federal Government and the monetary authorities, and cannot be secured through the development of direct controls over prices, wages, etc.

INTEREST RATES



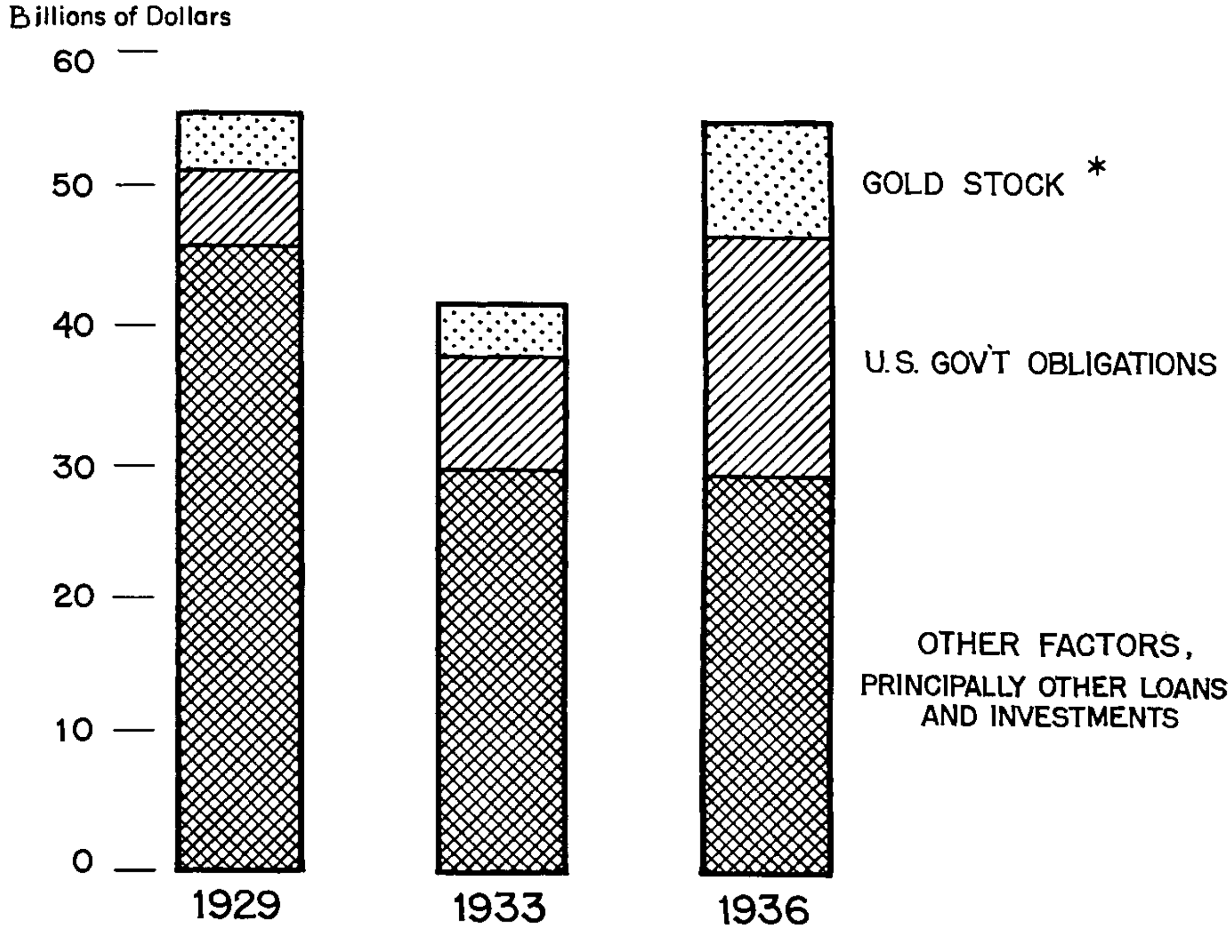
RESERVES AND CREDIT EXPANSION

(In millions of dollars)



TOTAL DEPOSITS AND CURRENCY
AND FACTORS AFFECTING THEIR VOLUME

(End of June)



Height of bars represents total bank deposits and currency outside of banks; segments of bars represent principal factors accounting for total.

* Excludes gold in Treasury cash